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No. 88-38

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

NORTHWESTERN BELL TELEPHONE COMPANY,
Petitioner,

v.

MINNESOTA PUBLIC UTILITIES COMMISSION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE MINNESOTA COURT OF APPEALS

APPENDIX FOR BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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C7-87-1296

STATE OF MINNESOTA
IN COURT OF APPEALS

NORTHWESTERN BELL TELEPHONE COMPANY,
Relator,

v.

MINNESOTA PUBLIC UTILITIES COMMISSION,
Respondent.

BRIEF AND STATUTORY APPENDIX OF NORTHWESTERN BELL TELEPHONE COMPANY

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LEGAL ISSUES

I. Did the Minnesota Public Utilities Commission Error in Finding that Northwestern Bell Engaged in Illegal Contacts Which Affected the Commission's 1984 Rate Case Deliberations in Final Rate Order?

The Commission ruled in the negative.

A. Was there any illegal conduct involved in any of Northwestern Bell's contacts with the Commission?

The Commission ruled in the affirmative.

B. Were the contacts "prohibited" ex parte contacts?

The Commission ruled in the affirmative.

C. Was the Commission's Finding as to the "public's perception" of the contacts supported by substantial evidence?

The Commission did not rule on this issue but based its finding on an assumption.

D. Did the contacts illegally affect the 1984 Rate Case Deliberations and Order?

The Commission ruled in the affirmative.

II. Does the Commission Have Statutory or Inherent Authority to Reopen and Vacate a Final Rate Order Which is Over 2¾ Years Old?

The Commission Ruled in the Affirmative with respect to inherent authority but did not discuss statutory authority.

III. Does the Minnesota Supreme Court's Decision in Henry v. MPUC That Northwestern Bell's Docket 600 Rates are Just and Reasonable Bar the Commission's Action in Docket 177 Under the Doctrine of Res Judicata?

The Commission ruled in the negative.

IV. Is The Commission's Order to Vacate, Reopen and Redeliberate a 2¾ Year Old Final Rate Case Order a Violation of the 10 Month Rule of *Minn. Stat.* 237.075?

The Commission ruled in the negative.

V. Were the Procedures Used By the Commission in Docket 177 a Violation of Northwestern Bell's Constitutional and Statutory Rights?

The Commission ruled in the negative.

STATEMENT OF THE CASE

Northwestern Bell Telephone Company ("Northwestern Bell" or "the Company") is a telephone company within the meaning of *Minn. Stat.* § 237.01, Subd. 2. The Minnesota Public Utilities Commission ("MPUC" or "the Commission") is an administrative agency which has authority pursuant to *Minn. Stat.* Chapter 237 to set Northwestern Bell's rates for intrastate telephone services under certain circumstances and after following certain statutory procedures.

This case ("MPUC Docket 177") is an appeal from an order of the Commission which collaterally reopened and vacated a 2¾ year old final general rate case order.[1]

A. Northwestern Bell's Last Rate Case—Docket 600

Northwestern Bell's current general telephone rates were established in MPUC Docket No. P-421/GR-83-600 — "Docket 600" — pursuant to a petition filed by the Company nearly four years ago on September 29, 1983. The Commission approved interim rates effective November 28, 1983 and after lengthy and complex rate proceeding the Commission issued a 100 page determination establishing rates on July 27, 1984 ("the 1984 Rate Order.")

The Commission's 1984 Rate Order was appealed, and in *Henry v. Minnesota Public Utilities Commission*, 392 N.W.2d 209 (Minn. 1986) the Minnesota Supreme Court held, among other things, that the rates established by the 1984 Rate Order were just and reasonable and supported by substantial evidence on the record. (*Henry, supra,* pp. 215-216). Thus, Northwestern Bell's current general telephone rates were established by a final order of the Commission which, prior to the issuance of the orders here in question, have been in effect for over 2¾ years.

B. The "Summary" Investigation — Docket 177.

On April 9, 1986 the Commission, in a separate docket — MPUC Docket No. U-999/CI-86-177 (hereinafter "Docket 177") — issued an order initiating a "summary" investiga-

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[1] If the Commission's action is not overturned, amounts up to or in excess of $40 million which have already been collected by the Company and expended on operational expenses, maintenance of service, capital improvements and dividends may be subject to unconstitutional confiscation. In addition, until corrected in future rate proceeding up to $11.9 million per year in future rates may be subject to unconstitutional confiscation. (MPUC Order, April 3, 1987, Docket 600.)

tion. (A - 1). The Commission's Docket 177 order noted the existence of various newspaper reports and governmental investigations relating to contacts alleged to have occurred between former Commissioners and various utilities, and stated the Commission believed it necessary to investigate whether any prior Commission decisions may have been adversely affected by improper contacts.[2]

The Commission, therefore, directed the Minnesota Department of Public Service ("DPS") to continue an investigation regarding these contacts which the DPS had begun two months earlier and also to conduct an investigation on behalf of the Commissions. (A - 2-3). On July 8, 1986 the DPS completed its investigation and issued a report summarizing the result of its summary investigation ("DPS Report"). (A - 4). Attached to the DPS Report were 7 depositions taken by the DPS during its investigation and 91 "exhibits" which were collected by or created by the DPS investigators.

The DPS Report made a number of findings and recommendations related to other parties and other dockets in addition to Docket 600 not relevant here. With respect to Docket 600, however, the DPS Report concluded that:

—During the 14-months that Docket 600 was pending before the Commission, a representative of the Company had

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[2] NWB has voluntarily assisted all said governmental investigations and has not been found to have violated any law by any of said governmental investigations, including the FBI and Ramsey County Attorney's investigations, referred to in the order. (NWB Petition for Reconsideration and Vacation, April 15, 1987, p. 2). Furthermore, a Federal judge has granted NWB a *complete dismissal* of a private federal civil suit brought in connection with some of the same allegations. *H. J. Inc. v. Northwestern Bell Telephone Company*, 648 F. Supp. 419 (D. C. Minn. 1986); and a state district judge has granted NWB a *complete dismissal* of a similar private state civil suit, *H. J., Inc. v. Northwestern Bell Telephone Company*, Minnesota Dist. Ct., Fourth Judicial Dist., File No. 86-24166, Judgment Docket, June 22, 1987.

a number of meetings with Commissioners in restaurants involving meals paid by the Company. (DPS Report, pp. 59, 64-65, A - 66, 71-72).

—The two Commissioners and the Company representative who participated in these meals all testified under oath that at no time did these meetings involve discussions of Docket 600 issues. (DPS Report, pp. 58-59, Depositions of Weir, Adams and Hanson, A - 65-66).

—During the period Docket 600 was pending there was no statute or rule in effect in Minnesota which prohibited a regulated Company from paying for meals consumed at meetings attended by Commissioners. (DPS Report, pp. 59-63, A - 66-70).

—It is unlikely that Commissioners could be bribed with free lunches or dinners. (DPS Report, pp. 58, A - 65).

—During the period Docket 600 was pending there was no statute or rule in effect which prohibited ex parte discussions between representatives of regulated companies and Commissioners. (DPS Report, pp. 66, A - 73).

The DPS Report contained no evidence or conclusion that any particular vote of the Commission in Docket 600 had been influenced either by the purchase of meals or by any discussions which occurred during the meals. The DPS Report did not recommend reopening or reconsideration of the 1984 Docket 600 Rate Order.

Upon receipt of this report the MPUC solicited comments from Northwestern Bell and other interested parties. (A - 89). Northwestern Bell gave written notice to the Commission and all parties that Northwestern Bell would object to any action taken by the Commission, based on the so called "evidence" created by the DPS under the "summary" investigative procedures utilized in Docket 177, to reopen or reconsider

the 1984 Docket 600 Rate Order. (NWB's Comments Regarding the MPUC's October 3, 1986 Order, dated October 22, 1986, pp. 16-17; A - 98-99).

C. The Petitions for Reconsideration or Dismissal of the Docket 600 Rate Order.

In July 1986 the Residential Utilities Division of the Office of Attorney General for the State of Minnesota ("AG-RUD" or "the Attorney General") filed a petition with the Commission requesting the Commission to reopen and reconsider the 1984 Rate Order in Docket 600 alleging that the Company had engaged in improper ex parte contacts regarding the Commission's rate case deliberations. (A - 100). The AG-RUD's petition was entirely based upon the DPS Report and the AG-RUD filed no evidence itself in support of its petition. The AG-RUD admitted in its petition that it had no knowledge of the specific content of any of the discussions which occurred between the Company representative and the Commissioners which were alleged to be improper. (AG-RUD Petition, July 9, 1986, p. 5, A - 105).

On August 14, 1986, the Minnesota Public Interest Research Group ("MPIRG") filed a petition with the Commission also based upon the DPS Report requesting the Commission to vacate and dismiss the 1984 Rate Order as well as the Commission's November 13, 1984 Order in Docket 600 relating to intervenor compensation. MPIRG filed no evidence in support of its petition. MPIRG also admitted in its petition that it had no knowledge of the contents of any alleged ex parte discussions. (MPIRG Petition, August 14, 1986, p. 9).

On October 22, 1986 the DPS filed comments with the Commission altering the DPS's earlier position and recommending that the Commission redeliberate the 1984 Rate Order in Docket 600. (Comments of DPS, October 22, 1986, p. 2).

Northwestern Bell filed responses to the Petitions of the AG-RUD and MPIRG and the DPS Comments which, in summarized form, asserted:

—The contacts about which the DPS, AG-RUD and MPIRG complain were not illegal.

—The contacts about which the DPS, AG-RUD and MPIRG complain were not prohibited "ex parte" contacts.

—The contacts about which the DPS, AG-RUD and MPIRG complain did not affect Docket 600.

—Under the circumstances of the "summary nature" of the proceedings in Docket 177, the MPUC has no legal authority to reopen, reconsider or dismiss the 1984 Rate Order in Docket 600.

—There are other substantial reasons for not reopening Docket 600. (NWB's Reply to Comments of the Other Parties, November 3, 1986; Response of NWB to Petition to Reopen and Reconsider filed by the AG-RUD, July 18, 1986; Response of NWB to Petition of MPIRG; NWB's Response to the AG's Reply Brief, September 15, 1986; Response of NWB to July 8, 1986 Report of the DPS to the MPUC, August 13, 1986).

D. The Commission's Deliberation and Order to Vacate and Reopen the 1984 Rate Order.

On November 7, 1986 the Commission met in Docket 177 and deliberated the AG-RUD and MPIRG petitions regarding the 1984 Rate Order in Docket 600. The Commission had not referred the matter to a contested case hearing and had no evidence before it except the disputed "evidence" created over Northwestern Bell's objection in the DPS summary investigation.

The Commission voted not to reopen any of the dockets recommended by the DPS in its original report. The Commission also voted to deny MPIRG's Petition to dismiss the Com-

mission's July 27, 1984 and November 13, 1984 Orders in Docket 600. The Commission did however vote to approve the AG-RUD's Petition to reconsider the 1984 Rate Order in Docket 600. (A - 107-108).

During the Commission's November 7, 1986 deliberations and vote to reopen and reconsider Rate Case Docket 600, no Commissioner indicated he or she was aware of any evidence, in the DPS Report or otherwise, that any particular vote in Docket 600 had in fact been influenced by any contact between any Commissioner and any representative of Northwestern Bell. (MPUC tape #86-166 (partial), tape #86-167, tape #86-168, tape #86-169, and tape #86-170 (partial)). During said deliberations several of the Commissioners commented that they had no knowledge as to what was discussed at any of the meal meetings which occurred between the Company's representative and former Commissioners Adams and Hanson and had no knowledge that any particular vote was influenced by the contacts. (MPUC tape #86-166 (partial), #86-167, tape #86-168, tape #86-169 and tape #86-170 (partial)).

Between February 12 - 19, 1987 the Commission met in Docket 600 and redeliberated on all the issues involved therein. At no time during the redeliberations and votes did any Commissioner state that the rates which had been previously established in Docket 600 were unjust or unreasonable. (MPUC tapes #87-36 through #87-65). The Commission voted, however, to change a number of the decisions which had been made in Docket 600 several years earlier. Those changes, if put into effect, would result in lowering the Company's annual revenue requirement by $11.9 million.[3]

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[3] The redeliberations and votes in Docket 600 and the MPUC's resulting orders of April 3, 1987 and June 4, 1987 in Docket 600 are the subject of a separate appeal to this court in *NWB Tel. Co. v. MPUC*, C9-87-1257.

On April 2, 1987 the Commission issued its final order in Docket 177 vacating the July 27, 1984 Rate Order in Docket 600. (A - 109). Northwestern Bell's Motion for Reconsideration was denied upon June 4, 1987. (A - 131). Northwestern Bell obtained a Writ of Certiorari to review said April 2, 1987 order and said June 4, 1987 order in this appeal.

In the event Northwestern Bell is successful in this appeal in reversing those orders in Docket 177, the 1984 Rate Order would be reinstated and Northwestern Bell's appeal in Docket 600, C9-87-1257, would be moot.

STATEMENT OF FACTS

As a "telephone company" within the meaning of *Minn. Stat.* § 237.01, Subd. 2 (1984) many of Northwestern Bell's intrastate business activities are subject to regulation by the Minnesota Public Utilities Commission pursuant to various provisions of Chapter 237 and Chapter 216A of the Minnesota Statutes. For example, the Commission has jurisdiction to determine appropriate changes in the general rates which the Company charges for its Minnesota intrastate telephone services. *Minn. Stat.* § 237.075.

Ratemaking, however, is not the only activity which brings Northwestern Bell into contact with the MPUC. (Wier Dep. 25-26). As defined by *Minn. Stat.* § 216A.02 the MPUC engages in some functions which are "legislative" in nature, some which are "administrative" in nature, and some which are "quasi-judicial" in nature.

An example of a legislative function would be the promulgation of rules having general applicability to all telephone utilities such as MN Rule 7845.0100, et seq. (A - 138). An example of an administrative function would be the issuance of policy statements, not amounting to formal rulemaking, regarding such matters as scheduling or staffing. Also, from

time to time the Commission meets informally with groups such as Senior citizens, the handicapped or investment analysts for general background information purposes. (Hanson Depo. 12). An example of a quasi-judicial function would be resolving disputed issues resulting from a contested case having particular applicability to the conduct of a particular regulated entity. Some of the issues in a ratemaking case such as Docket 600 fall into the quasi-judicial category.

In addition, the MPUC engages in other activities which can have an affect on the telephone industry in general and Northwestern Bell as one of its members. For example, from time to time the Company or Commission takes positions on issues before the state legislature as to changes in the law or additions to the law applicable to the telephone industry. (Weir Dep. 16-17). Commissioners and staff members would sometimes seek information regarding such legislative concerns from Northwestern Bell. (Madison Dep. 54-56).

During any given year there are hundreds if not thousands of topics of information which are of mutual interest to telephone companies such as Northwestern Bell and the MPUC. Some relate to particular pending matters but most relate to general background information. Furthermore, many fall into the legislative or administrative functions of the Commission and fewer fall into its quasi-judicial function. (Hanson Dep. 11-14).

In order to facilitate the transfer of information between Northwestern Bell on the one hand and the state legislature or the Minnesota Public Utilities Commission on the other, the Company has utilized its Government Relations/Regulatory Department. During 1984 and for eight years prior thereto Roy Weir was the head of that department. (Weir Dep. 21-23). There was a small group of employees, who had primary responsibility for issues and concerns related to the

state legislature who reported to Mr. Weir. There was a larger group of employees, who were primarily responsible for assisting Mr. Weir in preparing and providing information to the Commission and its staff and receiving information therefrom in connection with Regulatory matters. The total staff was about 32 or 33. (Weir Dep. 23-24). In addition the Company's Legal Department would coordinate its activities with the Regulatory Department in providing information to the Commission of a legal nature. (Weir Depo. 24-25).

1984 was an extremely eventful year in the corporate life at Northwestern Bell. It was the first year following the breakup of AT&T on January 1, 1984 it was the first year Northwestern Bell operated under the ownership of the newly created U.S. West, Inc. It was the first year that a number of U.S. West subsidiaries were created and began working out relationships with Northwestern Bell.

Similarly, state regulatory activities are significantly affected by regulation at the Federal level by the Federal Communication Commission ("FCC") and by the decisions of U.S. District Court Judge Harold Greene who presided over the AT&T breakup. It is important for the Commission to know how the Company views the effects of Federal regulation on its Minnesota operations.

During 1984 there was a veritable explosion of information related to the telecommunications industry in general and Northwestern Bell in particular completely unrelated to Docket 600. Some of it was related to technology, some was related to business concerns and some to state and regulatory issues. Most of this information had nothing whatsoever to do with particular pending quasi-judicial contested case issues such as Docket 600.

During 1984, however, the Commission did consider and decided the extent to which Northwestern Bell's request for

an increase in rates would be granted in Docket 600 which had been filed in September 1983.

In Docket 600 Northwestern Bell introduced testimony, exhibits and economic arguments through the normal contested case hearing process pursuant to *Minn. Stat.* § 237.075 and *Minn. Stat.* § 14.01, *et seq.* The Company argued in favor of and believed it proved to the Commission that its general rates should be increased to approximately $107 million a year (its original application for $109 million was lowered during the hearing process) and that its authorized rate of return should be set at approximately 16.5%. The Commission's decision in Docket 600 was issued July 27, 1984 to the following effect:

—The Commission voted to slash approximately $50 million from the amount of the revenue increase NWB requested resulting in a $57.5 million increase.

—The Commission voted to lower the Company's requested authorized rate of return from 16.5% to 14.5%.

—The Commission voted to order Northwestern Bell's transfer of its Yellow Pages business to U.S. West Direct to be null and void.

—The Commission also determined dozens of other issues many of which were against Northwestern Bell's positions. (MPUC Minutes re: Docket 600 Proceedings.)

During 1983, 1984, and 1985 Mr. Weir had a number of personal contacts with Commission members. As head of the Company's Regulatory activities Mr. Weir's signature appeared on cover letters and correspondence which passed thousands of pages of documents to the Commission and its staff on a variety of subjects. (Weir Depo. p. 25-27, also see MPUC correspondence files.) Some were related to Docket 600, most were not. Mr. Weir also had a number of meetings

with Commissioners in their offices as well as at other public locations such as restaurants. (Hanson Depo. 45-46, Adams Depo. 23-24). Some of these occurred on or near days the Commission was discussing Docket 600, but the vast majority did not.

While Docket 600 was technically "pending" from the time it was filed in September 1983 until it was finally concluded in October 1984, there were only two dozen days out of that 14 month (420 day) period on which any Commission activity occurred regarding Docket 600. (MPUC Order April 12, 1986, pp. 6-9, MPUC Minutes, September 1983 - October 1984). On 15 of these 420 days the MPUC's order selectively links, by time only, a date on which some Docket 600 activity occurred within three days (day before, day of, or day after) a meal occurring between Weir and one or more Commissioners. (MPUC April 2, 1987 Order, pp.6-9). At no time does the MPUC order find that any specific discussion occurred at any of the meal meetings regarding Docket 600.

The MPUC order fails to mention that the DPS Report also produced "evidence" that during the 24 month period from May 1983 through April 1985, ten of which involved no Docket 600 activity, there were a total of approximately 125 meal meeting attended by Weir and one or more Commissioner. (DPS Report, Exh. 17, Doc. "6," Exh. 18, Doc. "E" and Doc. "F," Exh. 23, Doc. "K", Adams Depo. Exh. 4 and Madison Depo. Exh. 3). Again, only 15 of these 125 meal meetings were within three days (day before, day of, day after) some MPUC rate case activity. One hundred ten were not. (See Exhibits and Minutes referred to in this and prior paragraph).

According to the depositions of Mr. Weir and Commissioners Hanson and Adams taken by the Department of Public

Services, Mr. Weir and both Commissioners had extremely busy schedules and they found it convenient to combine some of their discussions with meal time. These meals were paid for by Weir for which he was reimbursed by the Company. According to Company expense records Mr. Weir met more frequently with Commissioners Adams and Hanson but he also had at least some similar meetings with the other Commissioners.

Weir, Hanson and Adams have all testified under oath, however, that at no time at any of these meetings did they discuss the issues pending in Docket 600. (MPUC April 2, 1986 Order, p. 9 and DPS Report, p. 64). Furthermore, Hanson and Adams testified that neither was influenced in any way by the fact that the meals were provided at Company expense. (Adams Depo. 93-94, Hanson Depo. 53-57). Finally, Weir testified that he did not intend to influence the decision of the Commissioners Hanson and Adams regarding Docket 600 by the conduct of these meetings. (Weir Depo. 224-243, 257-261).

Furthermore, all three deponents testified that topics which were discussed at these meetings were legitimate topics. For example, both Hanson and Adams testified that they were former members of the state legislature. They testified that they first became acquainted with Mr. Weir while he was acting as a lobbyist on behalf of Northwestern Bell regarding the state legislature. (Hanson Depo. 10, 39-40; Adams Depo. 8). Thus, they were familiar with the practice of legislators meeting with lobbyists for lunch. They were also comfortable in meeting Weir because they had come to know him well. Both Hanson and Adams testified, however, that they knew their role as MPUC members was different than that as legislators, and thus avoided some topics of discussion, such as

contested rate case issues. (Hanson Depo. 22-24, 54; Adams Depo. 13-15, 25.)

During his deposition Hanson also was asked to explain why the meetings between Hanson and Adams were more frequent than other Commissioners. (Hanson Depo. 44). Hanson testified that since Adams and Hanson were former legislators, and since Weir had first met them in that capacity, "the three of us shared a common history." Their joint interest in that history and the politics associated with it formed the basis of many of their discussions. (Hanson Depo., p. 45). Hanson also testified that 1984 was the last year of his term on the Commission. Hanson testified that during 1984 he was approached regarding a vacant seat on the Minnesota House of Representatives and sought Weir's opinion regarding that subject because he valued Weir's legislative experience and political advice (Hanson Depo., p. 48). Hanson also testified that during 1984 there was general speculation that the senate seat formally occupied by Hanson might come up for election on short notice because the plans of the incumbent to seek another office. Hanson testified that he consulted with Weir regarding that subject. (Hanson Depo., 49-50). Hanson testified that he sought Weir's advice on whether it was worthwhile for him to seek reappointment to the Commission given the fact that Hanson was a member of the opposite political party from the Governor who would be making the appointment. (Hanson Depo., p. 50).

Hanson also testified that during this period one or both of Weir's parents died and Weir also was troubled from time to time regarding the serious illness of his granddaughter. Hanson testified that, "I have lost my mother and father and our families being the same age, although the families are not socializing together, we would talk at length about that."

(Hanson Depo., p. 50). Hanson testified that he believed during the same period he wrote an extensive "position paper" on the subject of "ameliorated rates." This in-depth position paper was on an issue not before the Commission at the time. Hanson testified he valued Weir's technical advice and political advice regarding this subject. (Hanson Depo., p. 51).

Hanson was specifically asked under oath whether he believed his personal relationship with Weir in anyway affected Hanson's view of issues pending before the Commission. Hanson replied as follows:

> . . . I realized that the process of making decisions in regulatory arena is a result of receiving expert testimony, receiving record evidence, and making a determination strictly on what the Commission has before it irrespective of who your friends are and even who your enemies are.
>
> I would say this is more, I would say some people can't understand this and I realize that. But is more a carryover from the legislative experience where it is not uncommon at all and I have experienced it myself, where you are in a position to make very important decisions quite often against your friends, quite often against the people, your roommate, quite often against the people in the political party and everybody in the legislative process understands very well that your votes have nothing to do with who you know well or how well you know a person.
>
> They are strictly based on the merits before us. (Hanson Depo., p. 54).

Weir also gave testimony concerning the legitimate topics of conversation which occurred during such meetings. Weir

testified that he made himself available to Commissioners so that if Commissioners saw problems with the way the Commission was operating they could bring it to his attention. Weir also testified that he made himself available to Commissioners at such meetings to clear up any rumors or hearsay they might have heard about the Company or to clarify any stories in the news media. (Weir Depo., p. 55).

Weir was a registered lobbyist under *Minn. Stat.* § 10A.01 et seq. (Lobbyist Reg. No. 5-0185-0673—DPS Report, Exh. 11). Weir filed quarterly disclosure forms with the Government Ethics Practices Board which disclosed the quarterly amount he spent on entertainment and food and beverages in connection with legislative or administrative lobbying. (DPS Report, Exh. 11, Weir Depo. 268).

Both Hanson and Adams testified that they had more discussions with policy advocates of the Department of Public Service, one of the other parties in Docket 600, than they did with Weir and that the nature and extent of their discussions of regulatory matters with Weir was not substantially different from that with the Department of Public Services representatives. (Hanson Depo. 157-160; Adams 95-96). No witness testified that any of the contacts involving Weir and the Commissioners at which meals were purchased involved discussions of Docket 600 issues.

ARGUMENT

I. THE COMMISSION ERRED IN FINDING THAT NORTHWESTERN BELL ENGAGED IN ILLEGAL CONTACTS WHICH AFFECTED THE COMMISSION'S 1984 RATE CASE DELIBERATIONS AND FINAL RATE ORDER.

The Commission's April 2, 1987 order in Docket 177 which vacated the 1984 Rate Order in Docket 600 purports to be

based upon certain contacts which occurred between a Company representative, Mr. Weir, and former Commissioners Adams and Hanson during the 14-month period between September 2, 1983 and October 23, 1984 while Docket 600 was pending. (MPUC April 2, 1987 Order, p. 10). The Commission found these contacts to be a serious abuse and violation of the regulatory process because they were (1) allegedly illegal ex parte contacts relating to the Docket 600 rate case proceeding and (2) because Northwestern Bell paid for the meals involved in these contacts allegedly creating an illegal conflict of interest for the Commissioners. (MPUC April 2, 1987 Order, p. 12).

It is clear, however, even from the summary nature of the DPS investigation and report, that none of these contacts were illegal and none of these contacts had any effect on the 1984 Rate Order. The Commission's conclusions to the contrary are not based upon substantial evidence in the record.

A. There Was No Illegal Conduct Involved in any of Northwestern Bell's Contacts With the Commission.

During the period in question, September 1983 through October 1984, there was no Minnesota statute, rule or regulation in effect which specifically prohibited a representative of a regulated company from paying for meals consumed by members of the Public Utilities Commission while matters involving the regulated company were pending before the Commission. Similarly, during said period there was no Minnesota statute, rule or regulation in effect which specifically prohibited a regulated company from engaging in ex parte contacts with members of the Public Utilities Commission. Furthermore, legislation which was in effect at that time implicitly authorized the contacts which the Commission now finds to be illegal. Finally, legislation and rules which have

been passed long after said contacts occurred unquestionably demonstrate that both the State Legislature and the Commission are aware that the contacts in question did not violate any prior existing law or regulation.

1. Meals as Conflicts of Interest.

The Minnesota Ethics in Government Act, *Minn. Stat.* Chapter 10A (1984), among other things, regulates lobbying activities. It is clear from § 10A.01 of the Act as it existed during the pendency of Docket 600, that lobbying activities in connection with administrative actions, including utility rate determinations, were covered by the Act. The Act, however, *did not prohibit* the purchase of meals in connection with such activities but merely required that lobbyists register and file quarterly disclosure statements in a proscribed format regarding lobbying disbursements. Furthermore, since the proscribed lobbying disbursement form (DPS Report, Exh. 11) had specific line items for disclosing "entertainment" and "food and beverages" for "administrative" lobbying, it is clear that during the period in question Minnesota law authorized registered lobbyists to purchase meals for public officials including members of the Public Utilities Commission. Mr. Weir was a duly registered lobbyist under the Act. (Lobbyist Registration No. 5-0185-0673—DPS Report, Exh. 11). As such Mr. Weir filed quarterly lobbyist disbursement reports with the Minnesota Government Ethics Practices Board on proscribed forms provided him by the state on which he disclosed the quarterly amounts he spent on food and beverages in connection with his administrative lobbying activities. (DPS Report, Exh. 11; Weir Depo. 268).

The Commission's findings, conclusions and order of April 2, 1987 and order denying reconsideration of June 4, 1987 totally ignore the applicability of *Minn. Stat.* Chapter 10A

(1984) to Mr. Weir's contacts in this matter. Furthermore, the Commission's orders totally ignore the finding of the DPS Report that the purchase of said meals was not a violation of law as it existed during the pendency of Docket 600. (DPS Report, pp. 58-62, A-66-70).

Similarly, the Commission's orders totally ignore the only Minnesota Statute which specifically discusses conflicts of interest and members of the Public Utilities Commission. *Minn. Stat.* § 216A.035 (a) (1984), as it existed during the pendency of Docket 600, specifically stated:

> No person during his term of membership on the Public Utilities Commission shall receive any *significant portion of his income* directly or indirectly from any public utility.... (Emphasis added).

Since the law at that time specifically stated that a Commissioner could receive *some* portion of his income from a public utility[4] so long as it was not a *significant* portion of his income, it is clear that the Commission's determination that NWB's purchase of meals for Commissioners Adams and Hanson was an illegal conflict of interest is without merit.

It is also important to note that in March 1986, long after the conduct in this case had occurred, the Minnesota State Legislature changed the law. *Minn. Stat.* § 216A.035 was amended in two relevant respects. First, it now prohibits members of the Public Utilities Commission from receiving any income from any public utility. Second, the 1986 amendments specify that the new prohibitions apply to telephone companies as well as public utilities. Thus, it is clear the state legislature has recognized that the conflict of interest pro-

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[4] *Minn. Stat.* § 216A.035(a) (1984) only applied to gas and electric public utilities in 1984. In 1986 it was amended to apply to telephone companies as well.

visions of the prior statute were not applicable to the present case. For the Commission to attempt to bring Northwestern Bell's 1984 conduct under the reach of a 1986 change in the law, therefore, would be a gross and obvious denial of due process.

2. Meals as Ex Parte Contacts.

In March 1986 the Minnesota State Legislature passed *Minn. Stat.* § 216A.037 which for the first time required the Commission to adopt rules regarding "permissible and impermissible ex parte communications." Prior to the passage of *Minn. Stat.* § 216A.037 in 1986 there was no Minnesota statutory nor regulatory definition of ex parte communications, let alone a prohibition against such communications in MPUC proceedings. The Commission has now adopted rules defining impermissible ex parte contacts. They did not become effective until 1987. (A-137). The legislative activity of the Minnesota State Legislature and the rulemaking activity of the Commission in 1986 and 1987, respectively, clearly underscores the fact that the contacts which occurred between Mr. Weir and Commissioners Hanson and Adams in 1984 were not then illegal. For the Commission to rely on *ex post facto* statutory and regulatory prohibitions to punish conduct which previously was perfectly legal would be a clear violation of due process of law.

B. The Contacts Were Not "Prohibited" Ex Parte Contacts.

The Commission's April 2, 1987 order in Docket 177 wrongfully characterizes the meetings between Mr. Weir and Commissioners Adams and Hanson as illegal ex parte contacts. However, even under the current statute (*Minn. Stat.* § 216A.-037 (1986)) and the new Commission rules (Minn. Rules Parts 78545.7000-78545.7600), which were not in effect dur-

ing 1984, a communication is not an illegal ex parte contact unless it involves communications regarding a "material issue" in a pending contested case proceeding or disputed petition. (A-137).

Thus, the mere fact that a party to a proceeding meets and has discussions with a Commissioner without other parties being present while a contested matter is pending is not a "prohibited" ex parte contact in and of itself. There must be probative evidence on the record that such a meeting also involved the discussion of a "material issue" in the contested proceeding to make the ex parte contact impermissible.

While the Commission's 1987 orders in Docket 177 ignore this "material issue" requirement of prohibited ex parte contacts, prior to the current controversy the Commission's own legal counsel did not. On August 1, 1985 the Special Assistant Attorney General assigned to the Commission issued a legal memorandum which gave the Commission some "guidelines" in answering the question, "what is an ex parte contact?" After providing a formal definition which included such requirements as (a) the communication must be "related to a specific case or docket," and (b) the communication must include, "specific facts relating to a specific utility or telephone" company, the opinion went on to state:

> However, not all contacts with parties or persons interested in a case are ex parte contacts. Inquiries that do *not address the merits of the case* . . . would *not* be considered an ex parte contact."

(Attorney General's Office Memorandum, August 1, 1985 referred to in DPS Report Exh. 69; A-141, emphasis added).

The contacts involving Mr. Weir and Commissioners Adams and Hanson which the Commission's April 2, 1987 order found to be illegal were not such contacts. Former Commis-

sioner Adams testified that at the meetings in question, "[W]e would discuss anything that was *not a contested case* before the Commission." (Adams Depo., pp. 13-14, emphasis added). Similarly, Hanson testified that he and Weir did not discuss "anything that would be even remotely or tangentially related to the 83-600 case." (Hanson Depo., p. 80). Furthermore Hanson testified that Weir did not attempt to influence Hanson's decision on the 600 case "during any of those meals or at any other time." (Hanson Depo., pp. 83-84). Weir also testified that he did not discuss contested case dockets or issues with the Commissioners ex parte. (DPS Report, p. 66, A-73).[5]

Since none of the petitioning parties to this docket have produced any *evidence* which refutes this sworn testimony, there is no evidence in the record which supports the Commission's finding and conclusion that Northwestern Bell engaged in *illegal* ex parte contacts during Docket 600. Thus, those portions of the Commissions orders should be stricken as not based upon substantial evidence in the record and the 1984 Rate Order should be reinstated.

C. The Commission's Finding as to the "Public's Perception" of the Contacts is not Supported by any Evidence in the Record.

In addition to the matters discussed in the previous section, the Commission made a number of other findings regarding Northwestern Bell's conduct during Docket 600 which are not supported by evidence in the record. One of these related to the "public's perception" of the contacts in questions.

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[5] There are many more similar sworn statements from Adams, Hanson and Weir which establish this point which are set forth in the Statement of Facts, *supra*, pages 13-16.

On page 12 of its order the Commission finds that Northwestern Bell's contacts with the Commission in connection with Docket 600 "have created an atmosphere of public distrust and lack of confidence in the regulatory process." On page 4 of its order the Commission states that the Commission is concerned not with whether the original decision in a Docket 600 was correct but with "the public's perception of the process" used in making that decision. There is, however, absolutely *no evidence* in the record as to what the public's perception is of that process or that supports the Commission's finding that Northwestern Bell created an atmosphere of distrust.

During the original Docket 600 proceedings in 1984, a number of public hearings were held in communities all over the state which enabled the public to testify as to their viewpoint on the merits of Northwestern Bell's rate increase application. In addition, during the 1984 Docket 600 evidentiary hearings some of the parties submitted public opinion survey data regarding some of the original issues contested in Docket 600. Thus, with respect to those original issues the Commission, the parties and the Administrative Law Judge felt it important and necessary to provide some evidence in the record as to the public's perception. With respect to the Commission's Docket 177 order to vacate and reopen the 1984 Rate Order, however, there was absolutely no public testimony taken regarding the public's perception of the alleged contacts or their affect on the Docket 600 ratemaking process, nor did any of the parties submit any public opinion survey data regarding said public's perception.

The Commission, nevertheless, based its cataclysmic decision to throw out a 2¾ year old rate order, not on evidence that particular votes or issues were improperly influenced,

but on the Commission's unsupported belief that the public distrusted the process. In fact, in the MPUC's official minutes of its motion and vote the Commission admits it was an "assumption" not a "finding." (A-107). Thus, the Commission's "finding" and conclusion in its Docket 177 order regarding the public's perception of the processes used in conducting Docket 600 not only lacks substantial evidence to support it but it lacks any evidence whatsoever. The Commission's findings, conclusions and order regarding the public's perception of the processes used in Docket 600, therefore, should be stricken.

D. The Contacts did not Affect the 1984 Rate Case Deliberations or Order.

As stated earlier Commissioners Adams and Hanson both gave sworn testimony during the DPS investigation denying that the contacts involving Weir had any affect whatsoever on their decision-making in Docket 600. None of the parties to Docket 177 have offered any *evidence* that any specific vote or decision made in Rate Case Docket 600 was affected by said contacts. In fact, a number of the parties have admitted in their pleadings in Docket 177 that they are not aware of what was discussed during the contacts in question and what effect any such discussions may have had on any particular issue in the case.

The Commission's April 2, 1987 order attempts to substitute disbelief, suspicion and inference for evidence to refute the uncontradicted sworn testimony of record. As noted by the FCC in *Re WORZ, Inc.*, 48 PUR 3rd 56 (1963), however:

> "Sworn denials, while not conclusive of the facts, are not to be brushed aside lightly on the basis of an indefinable 'normal human experience,' . . . *Suspicion, specula-*

tion, and conjecture are not proper substitutes for evidence, and cannot of themselves form the basis for conclusions that an applicant engaged in improper conduct requiring its disqualification and that two or more witnesses testified falsely. . . ." (*Id.*, p. 60-61, emphasis added).

Furthermore, during the deliberations in this matter a number of Commissioners admitted they did not know what Weir may have discussed with Commissioners Adams and Hanson and did not know that any particular vote was influenced in anyway by such contacts. (MPUC tape recordings #86-166 through #86-170). In fact, in its April 2, 1987 order the Commission specifically found that, ". . . it is difficult to accurately assess the effect NWB's actions had on particular votes on particular issues." (April 2, 1987 Order, p. 10).

It is also apparent from the original decision in Docket 600, however, and the Commission's later analysis of that decision that it was not improperly influenced in any way by the contacts in question. During the 1984 original Docket 600 proceeding, Northwestern Bell had requested and believed it had proved to be entitled to a rate increase in excess of $107 million. The Commission, however, voted to cut that request by approximately $50 million. The Company originally requested and believed it proved to be entitled to an authorized rate of return of 16.5%. The Commission, however, voted to cut that request to 14.5% (which also was lower than the then existing actual authorized return of 14.9%).

Two years later on August 21, 1986 the Commission received a report jointly prepared by the Commission staff and the DPS staff. (A-146). The Joint Staff Report analyzed the financial operations of the company for 1985, the first full year Northwestern Bell operated under the rates set by the 1984 Rate Order, and made the following conclusions:

—Based on 1985 economic data the Commission in 1984 had set the Company's authorized rate of return (14.5%) too low. It should have been set at 15.25%.

—The rates set by the Commission's 1984 Rate Order were also too low to allow the Company to earn either its authorized rate of return (14.5%) or the rate of return which should have been required (15.25%).

Thus it is clear that Weir's contacts with Commissioners Adams and Hanson in 1984 did not have a pro Company affect on the 1984 Rate Order. Otherwise, the Joint Staff Report would have found the Company's authorized rate of return and rates to be too high, not too low.

Since there is absolutely no evidence in the record that any of the alleged improper contacts had any affect on any decision made in Docket 600, there is no factual basis upon which the Commission can support its order to vacate and reopen the 1984 Rate Order due to tainted affect. All Commission decisions must be based upon substantial evidence in the record. *State v. Tri-State Tel. & Tel. Co.*, 204 Minn. 516, 284 N.W. 294, 300 (1939).

II. THE COMMISSION HAS NO STATUTORY OR INHERENT AUTHORITY TO REOPEN AND VACATE A FINAL RATE CASE ORDER WHICH IS OVER 2¾ YEARS OLD.

A. There is No Statutory Authority.

The Commission's sole authority for determining rates regarding Northwestern Bell comes from Minnesota Statutes, Chapter 237. There is no provision in that Chapter which authorizes the Commission to reopen and reconsider a telephone rate order once it has become final—let alone one that has been final for over 2¾ years.

Minn. Stat. § 237.075, Subd. 5 states that once the Commission has issued an order fixing the rates of a telephone

company and has served that order on the telephone company —all of which happened in this case in 1984—"the rates shall thereafter be observed until changed, *as provided by this Chapter.*" (Emphasis added.) Since the State Legislature has not provided the Commission authority under Chapter 237 to change a final rate order established pursuant to Chapter 237 other than by following the procedures set forth therein, the Commission does not have express statutory authority to reopen and vacate the 1984 Rate Order.

The MPUC is a creation of the State Legislature and its jurisdiction and authority are strictly limited as provided by statute. As noted by the Minnesota Supreme Court in *Great Northern Railway Co. v. Public Service Commission,* 284 Minn. 217, 220, 169 N.W.2d 732, 735 (Minn. 1969):

> It is elementary that the Commission, being a creature of statute, has only those powers given to it by the legislature. *Backus-Brooks Co. v. N. P. Ry. Co.,* (8th Cir.) 21 F.2d 4, 19, where the court said: It is well settled the powers of a state Commission are special and limited, and they can exercise only such authority as is legally conferred by express provisions of law, where such as is by fair implication and intendment incident to and included in the authority expressly conferred for the purpose of carrying out and accomplishing the objects for which the Commission was created, and that *any reasonable doubt of existence of any particular power in the Commission should be resolved against the exercise of such power.* (Emphasis added).

The Minnesota Supreme Court in recent years has continued to insist that the Commission live by this doctrine of limited express authority. *Peoples Natural Gas Co. v. Minnesota Public Utilities Commission,* 369 N.W.2d 530, 534 (Minn.

1985) and *Senior Citizens Coalition of Northern Minnesota v. Minnesota Public Utilities Commission*, 355 N.W.2d 295, 303-304 (Minn. 1985).

Furthermore, it is clear that the State Legislature knows how to grant the Commission the authority to reopen final rate orders if it feels that power is appropriate. In *Minn. Stat.* § 216B.25 (1986), the State Legislature explicitly gave the Public Utilities Commission authority in rate cases involving *gas and electric utilities* to reopen and rescind prior orders at any time. That statute, however, as well as the rest of Chapter 216B is specifically *inapplicable* to *telephone* rate determination cases. (*Minn. Stat.* § 216B.02, Subd. 4). While there are many provisions of Chapter 216B (the gas and electric statute) which are similar to Chapter 237 (the telephone regulatory statute), there is no provision in Chapter 237 remotely similar to the power to reopen and amend prior gas and electric orders as set forth in § 216B.25. Thus it is clear the legislature has never given, nor intended to give, the Public Utilities Commission the power to reopen a final telephone rate order such as the 1984 Rate Order.

This is especially clear from action taken by the State Legislature during its most recent session. During its 1987 session, the legislature had before it a bill, S.F. No. 1193 (A-177). Section 3 of S.F. No. 1193 proposed to amend Chapter 237 by adding a new provision to the telephone statute which would have given the Commission authority similar to the authority the Commission has to reopen and amend prior orders as set forth in the gas and electric statute, § 216B.25. The legislature, however, refused to adopt S.F. 1193 and give the Commission that authority. This court has relied on similar actions by the State Legislature in other cases as an indication of a legislative intent not to expand MPUC

authority by implication. *Application of Northwestern Bell Tel. Co.*, 367 N.W.2d 655, 661 (Minn. App. 1985).

The Commission's Docket 177 order to vacate and reopen the 1984 final rate order was, therefore, a clear abuse of its statutory authority.

B. The Authority Relied Upon by the Commission Regarding its "Inherent" Authority is not Controlling in this Case.

The Commission's April 2, 1987 Order contains a discussion of its authority to reopen and vacate the 1984 Rate Case Order. (April 2, 1987 Order, pp. 4-6, A-112). At the outset Commission, in effect, acknowledges it has no express statutory authority by its complete failure to cite any. Instead, the Commission begins by citing *State on State ex rel. Turnbladh v. District Court*, 259 Minn. 228, 107 N.W.2d 307 (1960) and *Anchor Cas. Co. v. Bongard's Coop. Creamery Ass'n.*, 253 Minn. 101, 91 N.W.2d 122 (1958). In doing so the Commission acknowledges that these cases are among those which stand for the proposition that, ". . . courts have expressed a strong disinclination to reopening orders and judgments after a reasonable time." (April 2, 1987 Order, p. 4). The Commission also acknowledges these two cases as holdings which prohibit state agencies, such as the MPUC, from reopening prior orders after agency jurisdiction is lost by appeal or lapse of time for appeal. Faced with the reality that the Commission in the present case had lost such jurisdiction due to the passage of time,[6] the Commission's order vainly attempted to distinguish *Turnbladh* and *Anchor Cas. Co.* rather than be bound by them.

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[6] The time for appeal of the 1984 Rate Order lapsed 30 days after the final order was issued or from the determination of any motion for reconsideration. *Minn. Stat.* § 14.63, § 14.64, § 237.25, and § 237.26.

The Commission's order asserts that these two cases only limit the authority of the Commission to correct erroneous decisions and that in the present case the Commission is not concerned with correcting an *erroneous* decision, "but with the integrity of the decision-making process itself, and the public's perception of the process." (April 2, 1987 Order, p. 4). This attempt by the Commission to create a meaningful distinction, however, fails for a number of reasons.

First, neither *Turnbladh* nor *Anchor Cas. Co.* make such a distinction. Thus, they cannot be relied upon as authority. Second, even if such a distinction were recognized by law in Minnesota, as indicated earlier there is no evidence on the record in this docket establishing what the public's perception is of the process. Third, the Commission cites no Minnesota decision or decision from another jurisdiction which states that a Minnesota administrative agency has "inherent" authority to do anything, let alone, to reopen a final administrative decision which is 2¾ years old. Nor does the Commission cite any authority allowing it to base such a decision on "public perception." Finally, the Commission's order completely ignores the only decision of a Minnesota court which is on point. In *Hough Transit Ltd. v. Harig*, 373 N.W.2d 327 (Minn. App. 1985) this court held that the decision of a Minnesota administrative agency (the Department of Economic Security) is res judicata with respect to a later attempt by the same agency to change it. In doing so this court stated that even if the agency had the power to reverse its earlier adjudication:

> . . . the second decision would be unlawful because not made within a reasonable time. The second representative's decision was made almost *two years after* the first representative's decision. (*Id.*, p. 332, fn. 1, emphasis added).

Since this court has held that the passage of less than two years would preclude the reopening of a final administrative order, the Commission in the present case was clearly without authority to reconsider and vacate its 2¾ year old order.

The Commission's order, however, goes on to cite decisions from several foreign jurisdictions and one Minnesota decision in its attempt to formulate its argument that the Commission has "inherent power" to remedy matter whenever it feels its regulatory process has been abused. Again, the Commission's citation of authority is faulty for a number of reasons. First, the Commission cites no authority which specifically states that state administrative agencies, in general, or Minnesota administrative agencies, in particular, have the "inherent power" to do anything let alone reopen a final rate case order which is over 2¾ years old. Second, the Commission's position regarding "inherent" authority is totally inconsistent with the limited express power doctrine discussed earlier in this brief. (II. A. pp. 27-30). Third, the Commission only cites one Minnesota case for this proposition which, simply put, does not apply.

Halloran v. Blue & White Liberty Cab Co., 253 Minn. 436, 92 N.W.2d 794 (1958), cited by the Commission, did not even involve an administrative agency, thus, it could not have involved the inherent power of an administrative agency. It involved the power of a *court* to reopen a prior court order. *Halloran* held that if one party to a lawsuit conducted in a state district court can prove that another party obtained a judgment by committing intentional fraud on the court, that court may vacate and modify the judgment. In doing so, however, the *Halloran* court noted that the moving party was basing its allegation of fraud on conduct which specifically involved Canon 30 of the Canons of Professional Ethics of

the bar association. The present situation is distinguishable from *Halloran* in that (a) there is no allegation that Northwestern Bell engaged in conduct which violated a specific statute, rule or regulation, and (b) Minnesota administrative agencies do not have the same powers as Minnesota state district courts.

Rule 60 of the Minnesota Rules of Civil Procedure specifically empowers Minnesota state district courts to reopen judgments obtained by fraud under certain circumstances. There is no similar grant of authority to the MPUC. In fact, the Minnesota Supreme Court has specifically held that the granting of rate determining authority to a Minnesota administrative agency is not the same as the granting of judicial powers. *State ex rel Halton v. Four Lakes Tel. Co.*, 141 Minn. 124, 169 N.W. 480 (1918). Thus, *Halloran* does not support the Commission's claim of "inherent" administrative agency power.

In addition, the Commission's April 2, 1987 order also relies on a number of decisions from non Minnesota jurisdictions which are equally inapplicable here. They all involve enabling authority and statutory schemes significantly different than that governing the MPUC.

Universal Oil Products Co. v. Root Refining Co., 328 U.S. 575, 66 S. Ct. 1176, 90 L. Ed. 1447 (1946), cited by the Commission, involved a party to an appeal before a federal appellate court who allegedly bribed one of the appellate justices with over $30,000 and obtained a favorable decision.[7] While dicta in the Supreme Court's opinion states that "a federal court" has the "inherent power" to "investigate whether a judgment was obtained by fraud," the court went

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[7] Facts from decision below, *Root Refining Co. v. Universal Oil Products Co.*, 169 F.2d 514 (3rd Cir. 1948).

on to hold merely that the attorneys involved in the case who acted as amici to the court in the investigation were not entitled to obtain attorney's fees from the losing party. The Supreme Court did not state anything about the "inherent power" of a state agency to reopen a prior decision. Furthermore, the Supreme Court specifically stated that even though a federal court has the inherent power to conduct an investigation, that if the rights of the party who obtained the prior judgment are to be adjudicated based upon the investigation "the usual safeguards of adversary proceedings must be observed." (Id., 328 U.S. at 580, 66 S. Ct. at 1179). Furthermore, the court went on to state, ". . . obviously, a court cannot deprive a successful party of his judgment without a proper hearing." (Id., 328 U.S. at 580, 66 S. Ct. at 1179). Thus, *Universal Oil* does not provide the MPUC with the authority it seeks in this case, nor does it approve the "summary" nature of the procedures used by the MPUC to vacate the prior order in this case.

Hazel-Atlas Co. v. Hartford-Empire Co., 322 U.S. 238 (1944), also relied upon by the Commission, was overruled in some respects later by the Supreme Court in *Standard Oil Co. v. California*, 429 U.S. 17 (1976). Even the original ruling in Hazel-Atlas, however, did not discuss the authority of a state agency. In Hazel-Atlas the Supreme Court held that when a circuit court of appeals makes a finding based on undisputed evidence that a party to an appeal had submitted a forged document to the court and paid a witness $8,000 to commit perjury in connection with the authenticity of the document, the court has the authority under its powers of equity to "devitalize" the prior judgment. Minnesota state agencies do not have the powers of equity that federal courts have and *Hazel-Atlas* does not say that they do.

WKAT, Inc. v. FCC, 296 F.2d 375 (1961) also did not involve the inherent power of a state commission. It involved the power of a U. S. Circuit Court of Appeals under a section of the Administrative Procedure Act, 5 U.S.C. § 1037 (c), to issue an order based upon a recommendation from the FCC. The issue involved in WKAT was who, among competing licensed applicants, was ertitled to a license to provide broadcast services to the public. The moral character of applicants was one of the issues the FCC was required by law to judge in making its decision. This is clear from the FCC opinion which stated:

> . . . the misconduct of [the applicants] reflects so adversely upon their character as to demonstrate that they lack the qualifications to operate the station sought in this application. . . (296 F.2d at 382).

It is also important to note that the FCC did not make its findings of misconduct on behalf of the applicants in *WKAT* based on a "summary" investigation. It appointed a hearing officer who conducted extensive hearings, who made findings, conclusions and an initial decision followed by exceptions being filed by the parties and a hearing and opinion by the FCC under the Administrative Procedures Act. The MPUC in the present case acted under different enabling authority and utilized summary procedures which ignored the requirements of the Minnesota Administrative Procedures Act.

Finally, *State ex rel. Corbin v. Arizona Corporation Commission,* 143 Ariz. 219, 693 P. 2d 363 (1984), cited by the Commission's order, is no more controlling than the others. First, the Corbin case is a decision under Arizona law, not Minnesota law. The Arizona Corporation Commission is created by the Arizona constitution rather than by the Arizona state legislature. Thus, while the Minnesota Public Utilities

Commission has been held only to have specific powers delegated to it by the state legislature, the Arizona Corporation Commission has powers in addition to those granted it by its state legislature. Second, in Corbin the regulatory commission acted prior to the issuance of a final order during a proceeding in which it learned that the attorney for an electrical utility and the director of the Commission's Utilities Division *admitted* engaging in a material ex parte contact with the administrative law judge—they drafted his proposed decision for him. In the present case the Commission acted over two years after the rate was final and had no evidence before it that any decision in question was actually affected by any ex parte contacts. Third, the *Corbin* court held that even under circumstances involved it was not required to dismiss the order or the case. Finally, in *Corbin* while the problem came to light prior to the issuance of the final order, the court noted that the defenses of laches would be applicable to circumstances involving greater delay. Thus, it is unlikely that even under Arizona law a rate order that had been final and operating for more than 2¾ years would have been reopened.

The MPUC's Docket 177 order then goes on to list five criteria it asserts should be utilized in exercising its alleged inherent authority for evaluating the need to reopen the 1984 Rate Order. In doing so, the Commission relies on *Northern States Power Co.*, Docket No. G-0002/GR-85-108, Order Vacating December 30, 1985 Order (February 19, 1986, Slip. Op.) (A-162)[8] and *Professional Air Traffic Controllers Organizations v. FLRA*, 685 F.2d 547 (D.C. Cir. 1982). Neither decision is applicable here.

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[8] This decision is currently on direct appeal to the Minnesota Supreme Court.

NSP involved a motion to reopen a prior order of the Commission brought within a few weeks of the issuance of the order reopened and within the time limits established by Commission rule for bringing motions for reconsideration. In the present case, that time limit expired several years ago. Also, in NSP the utility company itself was one of the parties who moved for and therefore consented to the reconsideration. In the present case, Northwestern Bell has never waived its right to be governed by the Minnesota Supreme Court approved 1984 Rate Order. Finally, in NSP the Commission was acting under different enabling legislation which specifically authorizes the reopening of rate orders in gas and electric cases at any time. Minn. Stat. § 216B.25. Rate case proceedings involving telephone companies are governed by Minn. Stat. Chapter 237 which, as was indicated earlier, has no similar provision authorizing the reopening of final orders.

In *PATCO, supra,* the court dealt with a violation of a federal statute which specifically prohibits ex parte contacts in federal administrative proceedings. In the present case, there was no statute, federal or state, which prohibited the contacts involving Northwestern Bell. Furthermore, in *PATCO* the court refused to set aside the agency decision involved despite the fact that the court found illegal ex parte contacts involving wining and dining had actually occurred in the case. The court did so because, despite the contacts, it found the final decision was not affected by the contacts. In the present case all the participants to the contacts have testified under oath that the Commission's decision was not affected by the contacts. Furthermore, the Commission made no finding that any specific issue or vote in Docket 600 was affected by any of the contacts.

Even if the five criteria the Commission derived from NSP/PATCO were applicable to the present case, however, they were not properly applied by the Commission. In addi-

tion the Commission, over Northwestern Bell's objection, ignored a sixth fundamental criterion.[9] The sixth fundamental criterion should have been formulated as follows:

> [6] What specific statute, rule or regulation, if any, was in effect during the relevant time period which prohibited each alleged conflict of interest or alleged ex parte communication?

As demonstrated earlier, there were no such applicable statutes, rules or regulations then in effect.

Furthermore, it is clear that the Commission did not even abide by the requirements of the five *NSP/PATCO* criteria it claimed to have set for itself. For example, the Commission listed as its second requirement, "Whether the contacts may have influenced the agency's ultimate decision." (April 2, 1987 Order, p. 6; A-114). This is an important criterion because in the *PATCO* case, which the Commission relied on in establishing its criteria, the court decided *not* to undo a prior decision despite the fact that it found illegal ex parte contacts had occurred during the case. The *PATCO* court also found, however, there was no proof that the final decision was improperly influenced by the statutorily prohibited contacts. If the Commission is going to rely on *PATCO* it should also follow it.

In the present case it is clear, however, the Commission did not apply the second criterion. On page 10 of its order, the Commission admits "it was difficult to accurately assess the effect NWB's actions had on particular votes on particular issues."[10]

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[9] NWB's Comments Regarding the MPUC's October 3, 1986 Order, dated October 22, 1986, pp. 15-16).

[10] Even this statement, which does not find there was an actual effect overstates the evidence. As indicated earlier there is no evidence on the record that any vote was affected and several Commissioners stated so during their November 7, 1986 deliberations.

Instead of applying the second criterion as stated, the Commission changed it and found not that any votes or issues had been affected but that an "impression" was created by Northwestern Bell's contacts of "an unduly receptive atmosphere." (April 2, 1987, Order, p. 10; A-118). The Commission cited no authority in support of this substituted criterion. Thus, the Commission failed to apply that criteria it said it was going to and the criteria it felt *PATCO* and *NSP* required.

Similarly, the Commission ignored its third *NSP/PATCO* criterion which it stated to be, "Whether the party making the improper contacts benefited from the agency's ultimate decision." This is a rather simple requirement to understand. Did Northwestern Bell, in fact, benefit in the final order from its alleged improper contacts.

Instead of applying this criterion, as stated, the Commission, ignored sworn testimony to the contrary, and found that the contacts in question were "intended" to benefit Northwestern Bell in Docket 600. (April 2, 1987 Order, p. 11). The Commission cited no authority for this substituted criterion. In addition, the Commission's finding under this criterion ignore contrary conclusions reported to it by its own staff.[11]

For the foregoing reasons it is clear that the Commission's order vacating the 1984 Rate Order was issued without statutory authority and the Commission's attempt to justify its actions based upon nonexistent inherent authority is meritless.

III. THE MINNESOTA SUPREME COURT'S DECISION IN *HENRY V. MPUC* THAT NORTHWESTERN BELL'S DOCKET 600 RATES ARE JUST AND REASONABLE BARS THE COMMISSION'S ACTION IN DOCKET 177 UNDER THE DOCTRINE OF RES JUDICATA.

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[11] See discussion of Joint Staff Report, *Supra*, 26-27.

The practical effect of the Commission's orders in Docket 177 vacating the 1984 Rate Order when combined with the Commission's action in Docket 600 is to illegally lower Northwestern Bell's rates which have been in effect for several years by $11.9 million a year. (See Commission order of April 3, 1987 in Docket 600).

As indicated earlier, Northwestern Bell's current rates were reviewed by the Minnesota Supreme Court in *Henry v. Minnesota Public Utilities Commission*, 392 N.W.2d 209 (Minn. 1986) and found to be just and reasonable and supported by substantial evidence in the record. (*Henry, supra*, pp. 215-216). Both the Commission and Northwestern Bell were parties of record to the *Henry* litigation. As such, both the Commission and Northwestern Bell are bound by the court's decision in *Henry* regarding the issue of whether or not the final order in Docket 600, the same order which is at issue in this proceeding, established rates that were just and reasonable.

Both the United States Supreme Court and Minnesota courts have held that the principles of res judicata apply to actions by administrative agencies. *U.S. v. Utah Construction & Mining Co.*, 384 U.S. 394, 422, 86 S.Ct. 1545, 1560, 16 L. Ed. 2d 642 (1966) and Hough Transit, Ltd. v. Harig, 373 N.W.2d 327, 332 (1985).

In *Henry* the court stated:

> "Based on our careful review of evidence in the record of this case and the 100-page order of the MPUC, we conclude that the decision of the MPUC was supported by evidence in the record and was not arbitrary and capricious. We therefore hold Northwestern Bell met its statutory burden of proof under Minn. Stat. § 237.075, Subd. 4 (1984) as to the rate increase order. (*Henry, id.*, p. 216).

Thus, in *Henry* the Minnesota Supreme Court has already ruled, as a matter of law, that the evidence in the record in Docket 600 establishes that the rates put into effect under the 1984 Rate Order were just and reasonable regardless of the procedures utilized in establishing those rates. The Commission, therefore, is bound by that decision and was not entitled to change it. If the Commission felt for whatever reason that Northwestern Bell's current rates which had previously been found to be just and reasonable were unjust and unreasonable, the Commission could have commenced a new rate proceeding to determine that issue and have afforded the company all its procedural rights under *Minn. Stat.* Chapter 237.

The Commission's deliberations in this matter totally ignored the applicability of the *Henry* decision until its order denying reconsideration of June 4, 1987 despite the fact that Northwestern Bell had repeatedly raised it throughout this proceeding. (NWB's Response to the AG-RUD's Reply Brief, September 15, 1986, p. 20; and NWB's Comments Regarding the MPUC's October 3, 1986 Order, October 22, 1986, pp. 43-44). The Commission's only response was to state that the issue of abuse of the Commission's process, which the Commission asserted as its legal basis for redeliberating Docket 600, was not before the court in *Henry*.

This response lacks merit for two reasons. First, it ignores the fact that in *Henry* the court held that *the evidence of record* supported the rates which were established as being just and reasonable. This would still be true even if NWB had attempted to bring additional evidence to the attention of the Commission regarding Docket 600 by ex parte means. (The latter circumstance, however, was denied under oath by all participants). The fact that the evidence of record support

the rate decision would also be true regardless of the motivation of the decision makers.

Second, the doctrine of res judicata not only bars issues which were raised and decided but also those which could have been raised. *In Re: McDonough*, 296 N.W.2d 648 (Minn. 1980); *Youngstown Mines Corp. v. Prout*, 266 Minn. 450, 124 N.W.2d 328 (1963); and *Nelson v. Dorr*, 239 Minn. 423, 58 N.W.2d 876 (1953). The Commission knew some of the facts involved in this matter as early as April 9, 1986 when it issued its order initiating the investigation. The Commission knew all of the facts upon which it based its decision as of July 8, 1986 when the Department of Public Services submitted its report. The Minnesota Supreme Court did not render its decision in *Henry* until a month later on August 8, 1986. Despite the fact that the Commission had this knowledge, it made no attempt to bring these issues to the attention of the Minnesota Supreme Court nor to request a stay of the appeal or remand of the case for the purpose of enabling the parties to deal with these issues and include them in the Docket 600 appeal.

Furthermore, the policy reasons underlying the doctrine of res judicata are applicable here. Parties need certainty and a reasonable end to litigation. Both the Commission and the Company need to be bound by prior Supreme Court decisions which declares particular orders of the Commission to be valid and final. Otherwise the conduct of any regulated business would be plagued with uncertainty and chaos.

Furthermore, any dissatisfaction the Commission had with the practices of parties in this case could have been and have been corrected by rulemaking. (A-137). Any concern regarding the present reasonableness or unreasonableness of the Company's rates can be resolved by the Commission's com-

mencing a new ratemaking proceeding rather than trashing one that has been in effect and final for several years.

IV. THE COMMISSION'S ORDER TO VACATE, REOPEN AND REDELIBERATE A 2¾ YEAR OLD FINAL RATE CASE ORDER VIOLATES THE 10 MONTH RULE OF *MINN. STAT.* § 237.075.

Even if the Commission had the authority and jurisdiction to vacate a 2¾ year old final order, and even if there were a proper factual basis for doing so based upon proceedings which did not violate the Company's due process rights, the Commission, nevertheless, should not have vacated the 1984 Rate Order and subsequently issued another rate order because the legal effect of said action is a violation of the 10 month rule of *Minn. Stat.* § 237.075, Subd. 2.

That statute requires the Commission to issue its final determination in a general rate case "within 10-months after the initial filing date." In the present case the initial filing date was September 29, 1983. The Commission's final determination of July 27, 1984 was within the 10 month period. The Commission's orders of April 2, 1987 and April 3, 1987 are well beyond it.

The Commission has stayed the ratemaking effects of its April 2, 1987 order in this matter and its new April 3, 1987 ratemaking order in Docket 600 pending judicial review of both orders. Once that stay is lifted, however, unless those orders have been overturned by this court the plain language of *Minn. Stat.* § 237.075, Subd. 2 would apply.

That statute specifically provides that in cases of a 10 month violation the schedule of rates initially filed by the Company (in this case calling for a $109 million annual increase) ". . . shall be deemed to have been approved by the Commission . . ." Thus, the legal effect of the Commission's

action of not issuing a "final determination" until after April 2, 1987 on a rate increase petition filed by the Company on September 23, 1983 would be to increase the Company's current rates by more than $50 million rather than decrease them by $11.9 million as the Commission intended to do in its April 3, 1987 order.

Furthermore, the Commission's own staff and the staff of the Department of Public Service advised the Commission in the Joint Staff Report[12] that the Commission's 1984 Rate Order established an authorized rate of return for the Company which was too low and established rates which did not produce sufficient revenue for the Company to earn either its authorized rate of return or required rate of return during 1985. Thus, while a rate increase resulting from the present docket would not be what the Commission intended, it would be no more inequitable than the Commission's decision to lower the Company's rates by $11.9 million annually in 1987 based on a 1983 test year without affording the Company due process of law.

V. THE PROCEDURES USED BY THE COMMISSION IN DOCKET 177 VIOLATED NORTHWESTERN BELL'S CONSTITUTIONAL AND STATUTORY RIGHTS.

Docket 177 was a summary investigation. (MPUC Order April 9, 1986 and MPUC Order, October 3, 1986). The DPS Report indicates that Northwestern Bell was officially designated a party to the investigation. (DPS Report, Ex. 55). Yet, the DPS Report also indicates Northwestern Bell was denied the rights of a party by the DPS during the investigation. For example, while the DPS required Northwestern Bell to

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[12] See discussion of Joint Staff Report, *Supra*, pp. 26-27.

have Northwestern Bell employees respond to interrogatories and requests for production of documents (DPS Report, Exhs. 49 and 53), the DPS refused to respond to interrogatories and requests for the production of documents propounded by Northwestern Bell. (DPS Report, Exh. 65). Northwestern Bell brought this to the Commission's attention but obtained no relief.

In addition, many of the exhibits to the DPS Report are documents which were not disclosed to Northwestern Bell during the investigation but only after the DPS Report was filed. [Exhs. 1-9, 11, 14-15, 30, 32, 37, 47, 51, 52, 55, 56 (Partial), 57-58, 59 (Partial), 63-64, 67, 71-72 and 91]. Since, many of the exhibits consist of affidavits or DPS memoranda to the file of interviews or telephone conversations regarding information provided to the DPS under circumstances which did not provide Northwestern Bell with notice or an opportunity to cross-examine or otherwise participate (Exhs. 32, 57-58, 67, 71 and 91) Northwestern Bell was denied fundamental due process rights in the manner in which these "exhibits" were compiled and unilaterally presented to the Commission.

The Commission, nevertheless, took administrative notice of the DPS Report, depositions and exhibits and considered them to be "evidence" of record. (MPUC Order, October 3, 1986, p. 3).

Northwestern Bell, therefore, gave written notice to the Commission and all parties to Docket 177 that, in addition to many other reasons, Northwestern Bell would object to any action taken by the Commission to reopen or reconsider the 1984 Rate Order based on the so called "evidence" created by the DPS under the "summary" investigative procedures involved in Docket 177. (NWB's comments, October 22, 1986, pp. 16-17).

The Commission did not order a contested case under *Minn. Stat.* § 237.075 and *Minn. Stat.* Chapter 14 as it had in producing the record which resulted in the 1984 Rate Order in Docket 600. Since this is a ratemaking proceeding which resulted in a lowering of the Company's rates based upon disputed issues and evidence, the Commission was required to do so. *State v. Tri-State Tel. & Tel. Co.*, 284 N.W. 294 (1939) ("Due process demands that rates be fixed only after a hearing attended by at least the rudiments of fairplay." *Id.*, at 300) and *Continental Tel. Co. of Minn., Inc.*, 389 N.W.2d 910 (Minn. 1986). Even under *Minn. Stat.* § 237.081, which was relied upon by the Commission in initiating Docket 177 (A-2) Northwestern Bell is entitled to a formal hearing prior to any order being issued which changes its rates. Northwestern Bell never received one.

It is Northwestern Bell's position that even assuming arguendo that the Commission has the authority to reopen a 2¾ year old final rate order, the Commission cannot and should not do so unless some party has produced evidence in a proceeding which affords Northwestern Bell its due process adversarial rights which meets a prima facie threshold enabling reopening. In its October 22, 1986 comments to the Commission, Northwestern Bell took the position that (1) since no party had come forward in Docket 177 with any evidence that Mr. Weir's contacts with Commissioners Adams and Hanson violated any statute, rule or regulation and (2) since there was no evidence that Docket 600 issues had ever been discussed in those meetings and (3) since all the sworn evidence of record established that no vote in Docket 600 had been affected by the contacts, the prima facie threshold had not been met and no further proceedings were appropriate or necessary.

If the Commission or any party disagreed with Northwestern Bell, the Commission should have submitted the matter to the Office of Administrative Law Judges for contested case pursuant to Chapter 14. The Commission's failure to do so resulted in the Commission issuing an order based on a record which denied Northwestern Bell statutory and constitutional rights.

Since the ultimate result of the proceedings in Docket 177 was to vacate an order which entitled Northwestern Bell to $56.5 million annually and later replaced with an order in Docket 600 which, if not reversed, would result in a $11.9 million reduction to Northwestern Bell, the Commission has confiscated Northwestern Bell's property in violation of its state and federal constitutional rights to due process and in violation of its statutory rights. *Bluefield Waterworks & Improvement Co. v. P.S.C. of W. Vir.*, 262 U.S. 679, 43 S. Ct. 675 (1923) and *State v. Tri-State Tel. & Tel. Co.*, 284 N.W. 294 (Minn. 1939).

CONCLUSION

For the foregoing reasons Northwestern Bell requests that this court reverse and vacate the Commission's orders in Docket 177 of April 2, 1987 and June 4, 1987 and reinstate the Commission's 1984 Rate Order.

Dated:

Respectfully submitted,
NORTHWESTERN BELL
TELEPHONE COMPANY

APPENDIX 2

C9-87-1297

STATE OF MINNESOTA
COURT OF APPEALS

NORTHWESTERN BELL TELEPHONE COMPANY,

Relator,

vs.

MINNESOTA PUBLIC UTILITIES COMMISSION,

Respondent.

BRIEF OF NORTHWESTERN BELL TELEPHONE COMPANY

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I. PROCEDURAL HISTORY

This case ("Docket 600") originated with a Petition for a general rate increase filed in September, 1983, by Northwestern Bell Telephone Company ("NWB"). After contested case proceedings, the Minnesota Public Utilities Commission ("MPUC") issued its initial decision on July 27, 1984 ("1984 Rate Order"). (A-6-106). The MPUC issued its Order After

Reconsideration and Rehearing on September 26, 1984. (A-107-119). On October 17, 1984 (A-120-127), the MPUC approved the implementation of new rates designed to increase NWB's authorized revenues by $57,511,000 annually. The new rates have been in effect since October 19, 1984.

A variety of appeals were taken from the MPUC's 1984 orders. This Court reversed two aspects of the MPUC's decisions (*see Application of Northwestern Bell Tel. Co.*, 367 N.W.2d 655 (Minn. App. 1985)), and the Minnesota Supreme Court affirmed these orders in all other respects in *Henry v. Minnesota Public Utilities Commission*, 392 N.W.2d 209 (Minn. 1986),[1] holding:

> "Based on our careful review of the evidence in the record of this case and the 100-page order of the MPUC we conclude the decision of the MPUC was supported by evidence in the record and was not arbitrary and capricious. We therefore hold Northwestern Bell met its statutory burden of proof under Minn. Stat. Section 237.075, subd. 4 (1984) as to the rate increase ordered." (392 N.W.2d at 216).

In April, 1986, the MPUC initiated a proceeding (Docket No. U-999/CI-86-177, ("Docket 177")) to investigate contacts between a Company representative and certain former Commissioners. The Department of Public Service ("DPS") conducted an investigation and submitted a Report to the MPUC on July 8, 1986. Thereafter, several parties to Docket 600

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[1] Additional appeals include *Application of Northwestern Bell Tel. Co.*, 371 N.W.2d 563 (Minn. App. 1985), *review denied*, Sept. 29, 1986 (relating to a January 10, 1985 order dealing with directory accounting matters), and *Application of Northwestern Bell Tel. Co.*, 374 N.W.2d 758 (Minn. App. 1985), *aff'd in part and reversed in part*, 386 N.W.2d 723 (1986) (relating to intervenor compensation in telephone rate proceedings).

moved the MPUC to reopen, reconsider or vacate the previous decisions in Docket 600. The Company opposed these requests.

The MPUC deliberated on these and other matters in November, 1986, and February, 1987. On April 2, 1987, it issued its order in Docket 177, vacating its 1984 Rate Order. The next day, the MPUC issued the Order After Redeliberation ("OAR") in Docket 600 based on the factual record, briefs and arguments presented in 1984. (A-130-269).

In the OAR, the MPUC reduced the previously authorized rate increase from $57,511,000 to $45,603,000 annually. (*See* A-267). The major revenue requirement changes made by the MPUC were: (1) to impute a hypothetical capital structure and hypothetical interest expense to NWB for purposes of calculating NWB's authorized rate of return and test year income tax expense (*Compare* A-78-79, *with* A-196-197, 226-231); (2) to impute $2.527 million of hypothetical directory revenues to NWB (A-71-74); and (3) to require NWB to continue to flow through in prospective rates a deferred income tax surplus that had already been flowed through in rates charged since 1982 (A-164-165).

The MPUC also altered the previously-approved metropolitan rate structure. (*Compare* A-103-104, para. b & c, *with* A-138, para. c) and, *sua sponte*, ordered NWB to provide certain services free to handicapped customers. (*Compare* A-104, para. m & n, *with* A-268, para. m & n).

NWB filed timely Petitions for Reconsideration of the OAR in Docket 600 and the April 2, 1987 order in Docket 177. By orders dated June 4, 1987, the MPUC denied both petitions. (*See* A-270-274 regarding Docket 600.)[2] The MPUC

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[2] NWB has separately appealed the MPUC's orders of April 2 and June 4, 1987, in Docket 177 to this Court in *Northwestern Bell Tel. Co. v. Minnesota Public Utilities Commission*, C9-87-1296.

denied reconsideration of the Docket 600 Petition without discussing any of NWB's substantive issues. However, it clarified and expanded its direction to NWB to provide free services to the handicapped. (Order Denying Reconsideration ("ODR") A-272-273).

NWB filed compliance tariffs as directed by the MPUC's orders, as well as tariffs and supporting documentation that more appropriately calculate the revenue impact, and the resulting rates for other services, of the MPUC's decision to require NWB to give away service. On July 21, 1987, the MPUC approved the compliance tariffs and rejected NWB's alternative tariffs and revenue calculations. (A-280-286).

On June 30, 1987, the MPUC stayed any requirements that NWB implement new rates pending the outcome of NWB's appeals. (A-275-279).[3]

II. ISSUES ON APPEAL

NWB separately appealed the MPUC's orders in Docket 177. Issues related to the propriety of the MPUC's decision to vacate the 1984 Rate Order will be addressed in that appeal and will not be addressed here.[4] If the Court determines that

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[3] The combined result of the Tier and handicapped services rate design decisions is that NWB's approximately 99,000 customers in Tiers 3 and 4 of the Metropolitan area will experience rate increases if the approved compliance tariffs are implemented, even though the MPUC reduced NWB's rate increase by approximately $12 million. By its ODR dated June 4, 1987, the MPUC specifically rejected a Suburban Rate Authority request that the MPUC reconsider the Tier decision. (A-274). However, a second petition for further reconsideration of the Tier issue was recently filed by the Suburban Rate Authority and that petition is presently pending before the Commission.

[4] Those issues include whether the MPUC had authority and jurisdiction to vacate the 1984 Rate Order in the manner in which it did, whether the procedures the MPUC followed were lawful, what is the appropriate legal impact of the MPUC's order vacating the 1984 Rate Order on NWB's current rates, and whether there was a factual record that supported the MPUC's vacation action.

the MPUC improperly vacated the 1984 Rate Order and reinstates the 1984 Rate Order, this appeal will be moot. However, if the Court affirms the vacation of the 1984 Rate Order, it will be necessary to consider the merits of the following issues raised in this appeal:

(1) Is the MPUC's decision to impute a hypothetical capital structure and cost of debt to NWB contrary to law, unsupported by substantial evidence and arbitrary and capricious?

(2) Is the MPUC's decision to impute hypothetical directory revenue to NWB contrary to law, unsupported by substantial evidence, and arbitrary and capricious?

(3) Is the MPUC's decision to require NWB to reduce rates prospectively due to a non-existent tax surplus contrary to law, unsupported by substantial evidence and arbitrary and capricious?

(4) Is the MPUC's decision to require NWB to provide services free of charge to certain customers contrary to constitutional principles and law, unsupported by evidence in the record and arbitrary and capricious?

(5) Were the procedures the MPUC utilized with regard to arriving at its decision contrary to NWB's constitutional right to due process of law, contrary to other legal standards and contrary to the provisions of Administrative Procedures Act?

III. STATEMENT OF FACTS

A. FACTS RELATED TO CAPITAL STRUCTURE.

In its OAR, the MPUC used a hypothetical capital structure to set NWB's rates, holding NWB had failed to establish the reasonableness of its actual capital structure. (A-227-230). Capital structure impacts the rate-setting process, because the cost of each type of capital (*i.e.*, debt and equity) is weighted

by its percentage of the total capital to determine NWB's overall rate of return.[5] (*See, Id.*, p. 103).

The record reflected the equity ratios of 17 telephone companies, including NWB:

Company	*Equity Ratio*
Cincinnati Bell	61.7%
Rochester Telephone	58.1%
AT&T	57.4%
Bell South	56.9%
Bell Atlantic	56.7%
Northwestern Bell actual	*56.4%*
Ameritech	56.2%
US West—used in 1984 Rate Order	*55.9%*
Southwestern Bell	55.4%
Southern New England Tel.	54.5%
NYNEX	54.9%
Pacific Telesis	53.5%
United Telephone	44.7%
Centel	43.5%
GTE	40.7%
Continental	38.8%
Mid-Continent	33.5%

[5] For example, if a company's capital structure were 60% common equity, at a cost of 15%, and 40% debt, at a cost of 10%, its overall cost of capital (its overall rate of return) would be 13% (60% x 15% + 40% x 10% = 13%). Capital structure also indirectly impacts allowable income tax expense, because interest paid on debt is a deductible expense for income tax purposes. Thus, hypothetically increasing the percentage of debt in a company's capital structure will not only reduce the overall rate of return (because debt is generally less expensive than common equity), it will also reduce allowed income tax expense by (hypothetically) increasing the interest deduction.

(Exh. 157, Sched. 2; Exh. 188, Sched. 11R, 13R; Exh. 150, Sched. 18.) The MPUC adopted a hypothetical equity ratio of 50.1%.

Four witnesses addressed the capital structure issue. William L. Bauhard, NWB's Assistant Treasurer, testified that NWB's service obligations require it to be able to raise large amounts of capital. That ability is enhanced by a AAA bond rating, which is affected by NWB's capital structure. (Exh. 15, pp. 5-6). Mr. Bauhard therefore recommended the MPUC use NWB's actual capital structure (56.4% equity, 43.6% debt) to set rates. (*Id.*, pp. 18-19). In rebuttal, Mr. Bauhard presented the capital structures of the seven regional Bell holding companies created at divestiture. Their equity ratios ranged from 53.5% to 56.9%, averaging 55.6%. (Exh. 188, pp. 26-27; Exh. 189, Scheds. 10R, 11R).[6]

Eugene W. Meyer, Vice President and Director of Kidder, Peabody & Co., explained that, to have ready access to the capital markets on reasonable terms, it would be essential for NWB to maintain a capital structure consistent with a AAA or AA bond rating. (Exh. 4, p. 11). Such a bond rating ensures access to a wider range of investors, thus enhancing NWB's ability to raise capital (*Id.*, p. 5). A lower bond rating would not produce a lower incremental cost of capital; however, if NWB's bond rating were lowered, raising it would be costly. (*Id.*, pp. 4-6; Exh. 5, App. C; Vol. 1, p. 146, lines 1-4).

Dr. Matityahu Marcus, testifying on behalf of the OAG, recommended the use of a capital structure consisting of 55% equity and 45% debt. (Exh. 149, p. 38). Later, the OAG

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[6] The testimony expressly states the *debt* ratios of these companies. Their equity ratios can be determined by subtracting the debt ratio from 100%.

urged the use of US WEST's actual capital structure containing 55.94% equity and 44.06% debt.[7] (Initial Brief of OAG, Vol. I, pp. 23-24).

Dr. Luther Thompson, on behalf of the DPS, recommended a structure of 50% equity, 43.6% debt and 6.4% imputed debt. (Exh. 196, p. 4). Asserting the MPUC must "balance" shareholders' needs against ratepayers' concerns, he argued the MPUC should not defer to NWB's actual capital structure "for regulatory purposes." (Exh. 156, pp. 4-5, 7).

Dr. Thompson based his recommendation on some—but not all—of the groups of companies analyzed by some of the rate of return witnesses. He calculated the average equity ratio of four telephone companies analyzed by Dr. Eilon Amit, the five telephone companies analyzed by Mr. Robert Morris,[8] the 25 electric companies analyzed by Mr. Bauhard, and four telephone companies and four electric companies analyzed by Dr. Litzenberger. Dr. Thompson selected these groups because their average bond ratings and average "betas" were similar to NWB's.[9] He also considered the capital structure used by the MPUC in NWB's 1982 rate case, containing 50.1% equity.

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[7] That, in fact, was the consolidated capital structure of US WEST's three operating telephone companies (Mountain Bell, Northwestern Bell and Pacific Northwest Bell). The structure thus did not reflect US WEST's other subsidiaries. (Exh. 189, Sched. 10).

[8] The Morris "group" contained the same four companies as the Amit group (Cincinnati Bell, Mid-Continent Telephone, Rochester Telephone and Southern New England Telephone) plus AT&T. (Exh. 157, Sched. 2, pp. 1-2). In fact, Mr. Morris analyzed the four "Amit" companies as a group, and AT&T separately. (Exh. 9, p. 7; Exh. 10, Sched. 2).

[9] "Beta" is a measure of the movement of the rate of return of a given stock, relative to the stock market as a whole. If that movement is relatively less than the market, the stock is perceived to be less risky than the market as a whole, and vice versa. (Exh. 7, p. 21).

(*Id.*, pp. 10-11).[10] He did not consider the Bell regional holding companies which were analyzed by Dr. Marcus (Exh. 149, p. 3), by Dr. Litzenberger in his supplemental testimony[11] (Exh. 217, p. 1), and by Dr. Amit in a secondary analysis. (Exh. 191, p. 36).

In its 1984 Rate Order, the MPUC rejected Dr. Thompson's recommendation:

> "The DPS analysis merely demonstrated that NWB's capital structure was not equal to the composite groups its witness, Dr. Thompson, had chosen for comparison purposes. Dr. Thompson never demonstrated that NWB's capital structure was imprudent or unreasonable. The Commission is not convinced by the DPS's argument and has rejected similar arguments in NWB, P-421/GR-82-203 at 32, and *NWB*, P-421/GR-80-911 at 45." (A-78).[12]

The MPUC, however, also rejected NWB's proposal to use its capital structure to set rates:

> "The Commission agrees that since divestiture, the same Bell System consolidated capital structure that the Company advocated using in its last rate case . . ., no longer exists and therefore it would be impossible to use that capital structure. However, although the actual entity has disappeared, the principle of using the parent company's consolidated capital structure, which has been the

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[10] In that case, decided before divestiture, the MPUC used the Bell System consolidated capital structure. (*Northwestern Bell Telephone Co.*, Docket No. P-421/GR-82-203, pp. 30-32 (April 20, 1983) ("203 Order")).

[11] Dr. Litzenberger withdrew his original analysis in favor of the analysis in his supplemental testimony. (Exh. 217, pp. 1, 16).

[12] In its 203 Order, the MPUC had stated:

> "The DPS analysis merely demonstrated that the Bell System equity ratio was not equal to the industry average, not that it was unreasonable or imprudent." (203 Order, p. 32).

> Commission's consistent practice in the last two NWB rate cases . . ., did not disappear with Bell System consolidated capital structure. The Commission finds it reasonable and appropriate, therefore, to use the consolidated capital structure of US WEST . . . to determine the overall rate of return in this proceeding." (*Id.*)

In the OAR the MPUC did an abrupt about-face. On the basis of two precedents—its own Central Telephone rate order (which had been *reversed* by this Court)[13] and a Louisiana Supreme Court decision[14]—the MPUC rejected the principle that it could impose a hypothetical capital structure only on a showing that NWB's actual structure was unreasonable. (A-227-229). Rather, NWB had the burden of proving the reasonableness of its actual capital structure, which, the MPUC held, it failed to do. (A-229-230). Relying on Dr. Thompson, the MPUC adopted a hypothetical capital structure containing 50.1% equity to set NWB's rates. (*Id.*, p. 101).

B. FACTS RELATED TO DIRECTORY ADJUSTMENT.

In 1983, NWB decided to have its directories published by US West Direct, an affiliate. To facilitate this transition, NWB transferred certain assets (charged against retained earnings of the shareholders) to Landmark Publishing (Direct's parent company) and entered into a series of contracts with Direct. (A-54, 197). The MPUC was notified of the transfer in December, 1983, and it directed that the issues related to the transfer be considered in Docket 600.

In its initial presentation NWB did not adjust its test year financials to reflect the change in operations; from the

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[13] *Central Telephone Company*, Docket No. P-405/GR-83-300 (March 30, 1984), *reversed, Central Telephone Co. v. Minnesota PUC*, 356 N.W.2d 696 (Minn. App. 1984).

[14] *South Central Bell v. Louisiana P.S.C.*, 373 So.2d 478 (La. 1979).

ratepayers' perspective, rates would be set as though NWB had remained in the publishing business. (A-54, 198). This approach insulated ratepayers from any claimed detrimental effects of the transfer.[15]

Based on incomplete data available in February of 1984, NWB's financial expert testified that the change in operations, if considered by the MPUC, would likely be beneficial to the ratepayers. The best information, then available to NWB (based on FCC/MPUC prescribed accounting procedures), indicated that the change in operations could reduce revenue requirements by about $827,000 annually. He also testified that this estimate—largely because of inadequacies in accounting data—was not sufficiently reliable for use in a rate analysis. (NWB Exh. 270, p. 26, lines 3-18).

Other parties objected to the transfer, urging the MPUC to set it aside and order NWB to resume directory publication. They also attempted to show that the ratepayers would be worse off after the transfer. For example, the OAG estimated NWB would lose about $9.6 million in 1985 revenue, while the DPS estimated the revenue loss in that year (if the transfer were recognized) would be $3,183,000.[16] But, as long as NWB's financial presentation was on a business-as-usual basis, *none* of these alleged losses would be reflected in

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[15] The only change reflected in the financial data was a change in capital structure that had the impact of *reducing* NWB's recommended rate of return by 4 basis points. Thus, the reflection of this effect was beneficial, not detrimental to the ratepayers.

[16] These estimates were succinctly critiqued in NWB's Reply Brief to the Hearing Examiner, dated May 4, 1984, at pages 172-178, copies of which are included in the Appendix at pages A-304-311, and in NWB's Supplemental Statement of Facts in its Reply Brief, at pages 2-7, in *Application of Northwestern Bell Tel. Co.*, 367 N.W.2d 655 (Minn. App. 1985), copies of which are included in the Appendix at pages A-312-318.

rates *until after the next general rate proceeding,* and then *only* if the MPUC found it appropriate to do so.

In its 1984 Rate Order, the MPUC ordered NWB to resume publishing directories. NWB appealed and this Court reversed; it held prior MPUC approval of the transfer was not required, but noted:

> "The Commission's hands aren't completely tied. If it decides the contract was not in the best interests of the ratepayer *and that the fees paid by West Direct to Northwestern were unreasonable,* it can make an adjustment to Northwestern's rate request." (367 N.W.2d at 661, emphasis added).

The Court of Appeals also held:

> "The Commission's order voiding the agreement transferring Northwestern's directory operations is reversed. Accordingly, this case is remanded to the Commission to enter findings consistent with this opinion and the Commission is ordered to reinstate the contract between Northwestern and West Direct. *The Commission can make a review of the transfer and its future impact on Northwestern's rates on a more complete record in the next rate case. If appropriate, an adjustment can be made at that time.*" (367 N.W.2d at 663, emphasis added).

On redeliberation in 1987, the MPUC accepted the 1984 Hearing Examiner's recommendation that pre-tax income be increased by $2,526,666 "to allow for the impact of the removal of directory operations during the time the rates would be in effect." The MPUC's stated rationale was that the "benefits [of the transfer] appear to lay heavily on the side of US West's shareholders without a corresponding benefit falling to Minnesota ratepayers." (A-203).

C. FACTS RELATED TO TAX FLOW THROUGH.

In the 1983 203 Order, the MPUC adjusted test year financials to amortize, over a three year period, an identified deferred tax reserve surplus resulting from a reduction in the federal tax rate from 48% to 46%. (A-29). Thus, commencing in July, 1982, NWB's rates were reduced to flow the alleged excess reserve back to the ratepayers. (A-30).

As part of the 1984 Rate Order, the MPUC decided to continue to flow the remaining excess deferred taxes through to ratepayers via reduced rates over the three year period:

> "The Commission finds that the reduction in the federal income tax rate from 48% to 46% was an extraordinary event that effectively created a surplus in the Company's accumulated deferred federal income tax account. *The Commission concludes that the surplus tax reserve should continue to be amortized over a three year period as ordered in NWB, P-421/GR-82-203* to insure that a greater proportion of the amortization will be received by ratepayers who actually paid income taxes at the prior 48% tax rates." (A-30, emphasis added).

The new October 1984 rates continued to reflect the flow through.[17]

Thus, since July, 1982, NWB's rates have been reduced for the express purpose of returning a specific tax surplus to the ratepayers. The MPUC's scheme was predicated upon specific adjustments to revenue requirements designed and intended to eliminate the surplus over three years. By late 1985 the entire surplus had been returned to ratepayers in the form of reduced rates.

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[17] The flow through had also been reflected in the interim rates established by the MPUC in November of 1983 in this proceeding because, pursuant to Minn. Stat. § 237.075, subd. 3, interim rates had to be based on the substantive decisions made by the MPUC in the 203 Order.

Nonetheless, in the OAR the MPUC ordered NWB to implement new rates (effective May 14, 1987), reflecting the continued flow through of the surplus that had been fully amortized nearly two years earlier. (*See* A-164-165). The MPUC also denied reconsideration without discussion of this issue.[18] (A-271).

D. FACTS RELATED TO FREE SERVICE.

NWB provides a variety of central office based optional services that simplify, expedite and enhance customers' ability to use the telephone. Two such services are Touch Tone and Speed Call 8.[19]

In the 1984 Rate Order, the MPUC concluded that Touch Tone is an adjunct to local service and increased the rates for that service in relationship to the local rate increase. (A-99). With regard to Speed Call 8, the MPUC generally agreed to the price increase proposed by NWB, but added:

> "The Commission is aware that the speed-calling feature may facilitate use of the telephone system by persons with certain physical or mental impairments. In order to facilitate the use of the telephone system by these persons, the Commission will set the rate for the speed-calling 8 feature at $1 for customers who indicate to the Company that the service is used by a physically or mentally impaired person." (A-100).

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[18] NWB argued this issue *for the first time* in its Petition for Reconsideration because the surplus *had not* been fully extinguished at the time of the 1984 Rate Order and because the MPUC did not allow the filing of new briefs or arguments prior to the issuance of the OAR.

[19] Touch Tone enables a customer to dial a number by pushing number buttons on the telephone, rather than using a rotary dial. Speed Call 8 service enables a customer to dial up to eight numbers by dialing preprogrammed two-digit codes, rather than the complete telephone number, for each of the eight preprogrammed numbers.

In the OAR the MPUC expanded the 1984 Rate Order as it affected these services. The MPUC determined that Touch Tone "may facilitate the use of the telephone system by persons with certain physical or mental impairments" (A-258) and ordered NWB to provide the service "to qualified physically or mentally impaired persons without charge." (*Id.*) The MPUC determined that Speed Call 8 service should also be provided free to those persons, instead of at the $1 rate established in the 1984 Rate Order. (A-259).

NWB requested reconsideration of both decisions, noting: (1) the scope of the order was unclear (*i.e.*, whether "without charge" applied to both recurring and non-recurring charges and to residential and business services); (2) the revenue effect of these decisions (based on company estimates) could be millions of dollars; (3) the lost revenues would have to be recovered from other customers; and (4) there was no evidence at all to support the MPUC's actions. The MPUC denied reconsideration, but clarified the OAR. First, the MPUC decided that *both* recurring and nonrecurring charges are to be foregone, but that the decision applies only to residential services. Eligible customers were defined as those having a household member certified by a qualified authority[20] to have a disability requiring the use of Speed Call 8 or Touch-Tone service. (A-272). Finally, the MPUC directed NWB to determine the amount of recurring and nonrecurring revenue obtained from the provision of these services to eligible customers during 1983. That amount was to be recovered in other rates. (A-273-274). In other words,

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[20] A "qualified authority" includes doctors, nurses, ophthalmologists, optometrists, therapists, professional staff of hospitals, institutions and public welfare agencies, and professional librarians or any person whose competence is acceptable to the Librarian of Congress. (A-272).

NWB was required to assume that providing services free would not increase the number of eligible customers who would subscribe.

NWB is aware of no evidence to support the MPUC's decision to require NWB to provide these services free, or the MPUC's method of calculating the revenue NWB will lose or the increased costs that NWB will incur as a result of providing these services free.

NWB's compliance filing included two sets of customer estimates and revenue calculations and rates: one based on the MPUC-ordered methodology, and the other on a methodology NWB believed would more closely track reality if NWB provides free service to substantial numbers of customers. The MPUC's order of July 21, 1987 (A-281-282), shows the following comparisons:

	MPUC Method	*Company Method*[21]
Touch Tone customers that will subscribe	38,489	232,889
Touch Tone recurring revenues foregone	$531,148	$3,353,748
Speed Call 8 customers that will subscribe	330	123,889
Speed Call 8 recurring revenues foregone	11,880	$4,429,080
Total non-recurring revenue foregone for both services	37,326	$1,429,080

[21] These numbers are apparently derived from NWB's filing that the MPUC refused to consider. However, the total number of Speed Call 8 customers and total non-recurring revenues as set forth in the MPUC's order (and thus in this chart) differ somewhat from the data filed by NWB.

The MPUC refused to consider NWB's estimates of lost revenue. It approved the compliance rates NWB filed based on the MPUC's method for estimating lost revenue. (A-283-284). Thus, if more current customers demand free services, NWB will lose the current revenues from those customers. If additional customers demand free services, NWB will not recover any of the non-recurring or recurring costs it will thereby incur.

Dozens of vendors (including Target, Sears, Wards, K-Mart, Radio Shack, Best-Buy, Penney's, Spiegel and AT&T and many others) sell or lease telephone equipment providing both touch tone and speed calling features in direct competition with the services NWB has been ordered to give away.

E. FACTS RELATED TO OTHER ERRORS.

1. Denial of Oral Argument.

When the MPUC issued the 1984 Rate Order the Commissioners were Leo G. Adams, Harry Seymour Crump, Roger L. Hanson, Terry Hoffman, and Cynthia A. Kitlinski. (*See* A-6, 107, 120). By the time the MPUC redeliberated and issued the OAR and ODR, Commissioners Adams, Hanson and Hoffman had been replaced by new Commissioners, Barbara Beerhalter, Robert J. O'Keefe and Darrel L. Peterson. (*See* A-130, 270.) Despite its requests, NWB was afforded no opportunity to present oral argument on the merits of its 1983 Petition to the majority of the Commissioners who issued the OAR (*See* A-284-285), or to present oral argument to any of the Commissioners on its Petition for Reconsideration of the OAR. (*See* A-286-288.)

2. Failure to Deal With Issues Raised In the Petition for Reconsideration.

After the issuance of the OAR, NWB filed an extensive Petition for Reconsideration pointing out many of the errors the MPUC made in the OAR, including: (1) the Supreme Court's decision in the *Henry* case, *supra*, barred the MPUC's action (*See* NWB's Petition, pp. 2-3, 26-27, 39-41); (2) this Court had reversed the *Central* decision, which the MPUC had relied upon as authority to adopt a hypothetical capital structure, and that this Court had reaffirmed the validity of *Northwestern Bell v. State*, 216 N.W.2d 841 (Minn. 1974), in *Petition of Northern States Power Co.*, 402 N.W.2d 135 (Minn. App. 1987) (*See* NWB's Petition, pp. 5-7); (3) the entire tax surplus had already been flowed back to ratepayers and the OAR subjected NWB to grave tax risks (*See* NWB's Petition, pp. 27-31); (4) the imputation of directory revenues is contrary to a prior Minnesota Supreme Court decision and this Court's decision in *Application of Northwestern Bell Tel. Co.*, 367 N.W.2d 655 (Minn. App. 1985) (*See* NWB's Petition, pp. 31-34); and (5) no evidence supported the MPUC's actions with regard to Touch Tone and Speed Call 8 services and those actions were arbitrary and capricious. (*See* NWB's Petition, pp. 37-39).

The MPUC's OAR did not discuss any of these matters. Neither did the ODR; rather, the ODR simply states:

> "The Commission finds that the parties have raised no new arguments or evidence in Petitions for Reconsideration that have not already been thoroughly considered by the Commission." (A-271).

3. Failure to Make Requisite Findings and Basing Prospective Rates on Out-of-Date Financial Data.

As noted earlier, the MPUC issued its OAR and the ODR based on a record created in 1984. One of the express purposes of those orders was to reduce NWB's rates commencing May 14, 1987. (A-266). When the MPUC issued those orders, it had no evidence before it to establish that the record compiled in 1984 was adequate to set prospective rates.

In fact, prior MPUC decision established the contrary. In June, 1986, the Federal Executive Agencies (based on matters unrelated to the MPUC's decision to redeliberate this case) asked the MPUC to investigate the reasonableness of NWB's current rates. (A-287). In that proceeding, Docket P-421/CI-86-354, the MPUC ordered the DPS and the MPUC staff to investigate the reasonableness of NWB's rates. (A-288-289). In mid-1986 the MPUC received a Joint Report showing that in 1985 NWB (based on the rates set by the MPUC in the 1984 Rate Order) had been unable to earn *either* its authorized return or the substantially higher market-required return. (A-292). Therefore, in an order dated October 24, 1986, the MPUC determined:

> "It is in the public interest to determine reasonable rates based upon a full, fair record. To make this determination, the Commission will need to know NWB's 1986 costs and revenues, and these are not yet known. *The Commission concludes that it must base its decision on complete 1986 data.*" (A-294, emphasis added).

The MPUC also observed that a variety of substantial pending matters would have a "significant financial impact on NWB's earnings after 1986. (A-294). Accordingly, the MPUC ordered NWB to submit a detailed financial filing on April 1, 1987. (A-295-297). NWB submitted that filing, and a

scant two days later, on April 3, 1987, the MPUC issued its OAR—based on 1983 data—cutting "current rates" by more than $12 million annually. Thereafter, on May 27, 1987, the MPUC further decided that it:

> "[C]annot resolve all questions regarding the reasonableness of NWB's current rates to its satisfaction and that sufficient grounds exist to warrant a contested case hearing to determine whether NWB's current rates are just and reasonable or would result in excessive and unreasonable earnings for the Company." (A-299).

Thus, in October, 1986, the MPUC squarely recognized that NWB's rates set in 1984 had been inadequate in 1985 and that careful examination of 1986 data was necessary in order to set prospective rates. Yet, in the OAR issued six months later, the MPUC used 1983 data to set prospective rates without affording NWB the benefit of any hearing at all. Two months after that, it decided it could not determine the reasonableness of the rates set by the OAR without contested hearings.

IV. ARGUMENT

A. THE MPUC ERRED IN USING A HYPOTHETICAL CAPITAL STRUCTURE TO SET NORTHWESTERN BELL'S RATES IN THE OAR.

In the OAR, the MPUC used a hypothetical capital structure, consisting of 50.1% equity, 43.6% debt and 6.3% imputed debt, to redetermine NWB's revenue requirement. That is contrary to the Supreme Court's decision in *Henry, supra,* contrary to law, arbitrary and capricious, and not supported by substantial evidence, considering the record as a whole. The MPUC should have used US WEST's actual capital structure (55.9% equity, 44.1% debt), as it did in its 1984 Rate

Order[22] or NWB's capital structure (56.4% equity, 43.6% debt), as NWB recommended.[23]

1. The MPUC's Capital Structure Determination is Barred by the Supreme Court's Decision in the *Henry* case.

In the OAR, the MPUC stated:

> "[T]he Commission concludes that NWB has presented no convincing evidence as to the reasonableness of its capital structure for ratemaking purposes and has thus failed to sustain its burden of proof . . . ." (A-230).

The MPUC is wrong as a matter of law.

In the 1984 Rate Order, the MPUC considered the capital structure issue and determined to use US WEST's capital structure, based on its application of "the unreasonable or imprudent" standard and its view that the evidence presented by the DPS was insufficient to establish unreasonableness. (A-78). That Order was appealed ultimately to the Supreme Court, which disposed of a challenge to the sufficiency of the evidence as follows:

> "We will review the MPUC's determination of a just and reasonable rate in this case *according to the substantial evidence standard for rate of return determinations* and the arbitrary and capricious standard for rate design determinations. (citation omitted) Based on our careful review of the evidence in the record of this case and the

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[22] The MPUC adjusted US WEST's capital structure to remove the effects of NWB's transfer of directory operations to US WEST Direct, which it had attempted to void. (1984 Rate Order, p. 75). This Court later overturned that attempt. (*Re Northwestern Bell Telephone Company*, 371 N.W.2d 563 (Minn. App. 1985)). Thus that adjustment is no longer appropriate.

[23] This error affected not only the calculation of the overall rate of return, but also the calculation of interest for purposes of ascertaining test-year tax expense and the calculation of cash working capital. These aspects of the OAR must also be corrected.

> 100-page order of the MPUC, we conclude the decision of the MPUC was supported by evidence in the record and was not arbitrary and capricious. *We therefore hold Northwestern Bell met its statutory burden of proof* under Minn. Stat. Sec. 237.075, subd. 4 (1984) as to the rate increase ordered." (*Henry v. Public Utilities Commission*, 392 N.W.2d 209, 216 (1986), emphasis supplied).

In assessing the rate of return evidence, the Supreme Court had to consider capital structure. As this Court has stated:

> "Capital structure is one component used in determining overall rate of return by weighing the cost of capital by its percentage in the company's capital structure— . . . . " (*Petition of Northern States Power Co.*, 402 N.W.2d 135, 140 (Minn App. 1987)).

The issue of capital structure was fully litigated before the MPUC in 1984 and reviewed by the Supreme Court, which held, as a matter of law, that NWB met its burden of proof. That determination became the law of the case, and the MPUC cannot now reverse it. *Janssen v. Neal*, 256 N.W.2d 292 (Minn. 1977); *State by Johnson v. Sports & Health Club*, 392 N.W.2d 329 (Minn. App. 1986). Nor can this Court change the result on this appeal:

> "There exists a well-established rule that issues considered and adjudicated on a first appeal become the law of the case and will not be reexamined or readjudicated on a second appeal of the same case." *Lange v. Nelson-Ryan Flight Service, Inc.*, 263 Minn. 152, 155, 116 N.W.2d 266, 269 (1962).

This rule applies to matters adjudicated before the MPUC and reviewed by the appellate courts. *See Minnesota Power & Light Co. v. Minn. P.U.C.*, 342 N.W.2d 324 (Minn. 1983).

Moreover, once the MPUC's 1984 Rate Order, which utilized the "arbitrary or imprudent" standard, was affirmed by the

Supreme Court on this issue, the MPUC was powerless to use a different standard in its redeliberation:

> "Since our prior decision the membership of the court has changed. If we were to assume that the arguments of the defendant presently advanced on the issues previously determined might now be persuasive to a majority of the court, we nevertheless are not at liberty under this rule to engage in a reexamination, much less to so declare. This attitude is consistent with the rule of the law of the case and is founded upon a policy which requires that issues once fully litigated be set at rest." *Lange v. Nelson-Ryan Flight Service, Inc., supra,* 263 Minn. at 155, 116 N.W.2d at 269.

Regardless of the merits of the standard used in the OAR, the MPUC erred by using it in the face of a contrary Supreme Court decision on the prior appeal.

2. The MPUC's Capital Structure Decision is Contrary to Established Law.

The seminal case concerning the regulatory treatment of capital structure issues in Minnesota is *Northwestern Bell v. State,* 299 Minn. 1, 216 N.W.2d 841 (1974). There the Supreme Court stated:

> "We have difficulty accepting the concept that *in a rate case of this kind* the state may collaterally attack the judgment of the company in maintaining its embedded debt at a low figure. We agree with the position of the company that *this is a discretionary matter of management . . .*" (*Id.* at 14-15, 216 N.W.2d at 850; emphasis supplied).

Though this passage plainly states a general rule, the MPUC dismissed it as merely reflecting the state of the record, which did not contain "competing capital structure proposals." (A-228-229).

This Court has considered—and reaffirmed—the application of *Northwestern Bell* to capital structure issues three times.[24] *Peoples Natural Gas Co. v. Minnesota P.U.C.*, 342 N.W.2d 348 (Minn. App. 1983), involved an unincorporated division of InterNorth. Since it had no capital structure of its own, Peoples proposed the use of InterNorth's capital structure; the MPUC used a hypothetical structure containing less equity. This Court held the MPUC did not have to find Peoples' structure unreasonable before it could use a hypothetical capital structure because:

> "*Northwestern Bell* applies to utilities that have an objective capital structure of their own." (*Id.* at 352).

With no objective capital structure, Peoples' proposal was hypothetical and thus entitled to no deference.

In *Central Telephone Co. v. Minnesota P.U.C.*, 356 N.W.2d 696 (Minn. App. 1984), the MPUC used the capital structure of Centel, Central's parent, rather than Central's own structure. (*Id.* at 698). The MPUC held *Northwestern Bell* no longer applied because of the intervening passage of Minn. Stat. § 237.075, subd. 4, and that Central had to prove the reasonableness of its capital structure. (*Id.* at 702). This Court rejected the notion that this statute had implicitly overruled *Northwestern Bell*, noting that its *Peoples Natural Gas* opinion had expressly stated the continued vitality of that decision. Thus, the MPUC's decision was based on an error of law. (*Id.*)[25]

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[24] The most telling fact about the OAR is its disregard of these three decisions, which received *no* mention.

[25] Here, the MPUC made essentially the same argument, stating:

> "a substantive or legal presumption in favor of a company-proposed capital structure . . . would be inconsistent with . . . Sec. 237.075, subd. 4 . . ." (A-228).

Finally, in *Petition of Northern States Power Co.*, 402 N.W.2d 135 (Minn. App. 1987), the MPUC imposed a hypothetical capital structure, stating:

> " 'NSP has not come forward with sufficient evidence to justify the reasonableness of its capital structure for ratemaking purposes.' " (*Id.* at 140).

With a citation to Northwestern Bell, this Court reversed the MPUC, holding it should have utilized NSP's actual structure, "especially since the record shows it to be within the normal range for comparable utilities." (*Id.*)

There can be no question of the continued vitality of *Northwestern Bell,* or of its applicability to NWB, which has its own capital structure. Nor can there be a serious question as to the meaning of the case, though the MPUC asserts otherwise:

> "The Commission does not believe that the Supreme Court in [*Northwestern Bell*] *v. State* established as a matter of law that the Commission must first determine that the company-proposed capital structure is unreasonable before it evaluates or selects an alternative proposal. In that decision the Court conducted its review on the basis of the record before it. That record did not contain competing capital structure proposals." (A-228).

The short answer is that both *Central Telephone, supra,* and *Northern States Power, supra,* contained "competing capital structure proposals," yet, in each case, this Court reversed the MPUC's attempt to require the utility to prove the reasonableness of its actual capital structure. Indeed, *Central Telephone* is virtually indistinguishable from this case—except that the "hypothetical" capital structure there was the parent's actual structure; here, the MPUC used a wholly fictitious structure.

In *Central Telephone*, this Court noted the MPUC's "strict adherence to *Northwestern Bell* in recent cases," in which the MPUC had used the unreasonable or imprudent standard. (356 N.W.2d at 702). In other words, that standard is the standard of *Northwestern Bell*, just as the Company has claimed all along.

3. The MPUC's Capital Structure Determination Is Arbitrary and Capricious.

The MPUC's capital structure determination is also contrary to its own precedents. In NWB's 1982 general rate proceeding, the MPUC stated:

> "In *Northwestern Bell Telephone Co. v. State* . . . the Minnesota Supreme Court indicated that the Commission may not readily substitute its judgment for that of company management on the issue of appropriate capital structure. While this decision does not give utility management absolute discretion, the Commission believes that the capital structure must be found unreasonable or imprudent before the Commission chooses a different structure." (203 Order, at 32; *See also, United Telephone Co.*, Docket No. P-430/GR-82-200 (April 27, 1983)).[26]

While the MPUC can overrule its own precedents, it must provide sufficient reasons for doing so. (*Central Telephone Co. v. Minnesota P.U.C., supra,* 356 N.W.2d at 702; *Peoples Natural Gas Co. v. Minnesota P.U.C., supra,* 342 N.W.2d at 352-53).

Here, the MPUC made no effort to justify its departure from its own precedents. Instead, it simply denied the conflict, stating that:

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[26] In the 1984 Rate Order in this proceeding, the MPUC dismissed the DPS's recommendation, stating: "Dr. Thompson never demonstrated that NWB's capital structure was imprudent or unreasonable." (A-27).

> "in so far [sic] as they may be interpreted to suggest that there must be a finding of unreasonableness of a company's proposed structure before an alternative is entertained, [these decisions] are clarified by this Order." (A-229).

But the 203 Order flatly stated:

> "the Commission believes that the capital structure must be found unreasonable or imprudent before the Commission chooses a different structure." (203 Order, p. 32).

That these words require "clarification" is dubious, at best; that they can be interpreted as the MPUC now suggests—the opposite of their plain meaning—is nonsense. The words simply will not bear the meaning the MPUC now wishes them to carry, and no reasonable person could so find.

To support its conclusion in the OAR that NWB had the burden of proving the reasonableness of its capital structure, the MPUC cites and relies on Minn. Stat. § 237.075, subd. 4. (A-227). But this Court has expressly rejected the notion that this statute overruled Northwestern Bell and requires the utility to prove the reasonableness of its capital structure. (*Central Telephone Co. v. Minnesota P.U.C., supra,* 356 N.W. 2d at 702).[27]

The MPUC must "give reasons for departing from its prior norms and decisions." (*Id.*) Implicit in that is the requirement that the reasons form a legitimate basis for the decision, which plainly is not the case here. The MPUC's decision is arbitrary and capricious and must be reversed. (*Id.*)

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[27] The OAR also cites Rule 301 of the Minnesota Rules of Evidence as support for the four-step procedure the MPUC purported to follow here. (A-228). However, the MPUC denied any intent to effect substantive changes by means of this procedure (*Id.*), and Rule 301 has nothing to say about who has the burden of proof on a given issue in a rate case.

4. The MPUC's Capital Structure Determination Is Not Supported By Substantial Evidence Viewing the Record Whole.

No matter who had the burden to prove what, the record establishes the reasonableness of NWB's actual capital structure. The seven regional Bell holding companies created at divestiture provide the vast bulk of exchange telephone service in this country, serving some 80% of all telephone subscribers. (*See United States v. Western Elec. Co., Inc.*, 569 F. Supp. 990, 993 n. 8 (D.D.C. 1982)). The record indicates that these companies' equity ratios range from 53.5% to 56.9%, averaging about 55.6%. (Exh. 189, Scheds. 10R, 11R; Ex. 188, pp. 26-27). NWB's equity ratio of 56.4% and US WEST's equity ratio of 55.9% are thus "within the normal range for comparable utilities" and should not have been rejected by the MPUC. *Petition of Northern States Power Co., supra,* 402 N.W.2d at 140.

Unwilling or unable to contradict or explain away this evidence, the MPUC just ignored it. The OAR makes no mention of the equity ratios of the regional Bell holding companies, even though they were put into the record expressly for the purpose of demonstrating the reasonableness of NWB's actual capital structure. (Ex. 188, pp. 26-27).

This is particularly outrageous, in that the MPUC, citing Dr. Thompson's testimony, surveyed *some* of the comparable groups used by *some* of the rate of return witnesses in their cost of equity analysis, to determine its hypothetical capital structure. (A-230-231). These groups did not include the regional Bell companies, even though they were the subject of Dr. Marcus's and Dr. Litzenberger's rate of return analyses (Ex. 149, p. 3; Ex. 217, p. 1) and of Dr. Amit's secondary analysis. (Ex. 191, p. 36). Instead, the MPUC looked at the capital structures of the four telephone companies ana-

lyzed by Dr. Amit, the same four companies, plus AT&T, analyzed by Mr. Morris, four telephone companies and four electric companies initially analyzed by Dr. Litzenberger (who later discarded that analysis in favor of a subsequent analysis of the regional companies), and 25 electric companies analyzed by Mr. Bauhard. The MPUC's "analysis" of these groups consisted of calculating their mean (average) equity ratios and averaging the averages. (Ex. 157, Sched. 2).

Two of the five groups were from another industry: forty percent of the analysis did not even involve telephone companies. One of the three groups of telephone companies (Centel, Continental Telephone, Mid-Continent Telephone, and United Telephone) came from a rate of return study withdrawn by its sponsor. The other two groups each consisted of four companies (Cincinnati Bell, Mid-Continent Telephone, Rochester Telephone, and Southern New England Telephone) plus, in one case, AT&T. Thus, Mid-Continent Telephone—a tiny fraction the size of NWB—was counted three times, while the regional Bell companies—80% of the industry—were ignored. Rational decisions are not made this way.

The three telephone-company groups relied on by the MPUC have a total of eight companies, with equity ratios ranging from 33.54% to 61.69%. (Exh. 158). One can conclude from these data only that telephone companies have vastly different capital structures, which is essentially what the MPUC concluded in the 1984 Rate Order and in the 203 Order, when presented with similar data (A-78; 203 Order, pp. 31-32).[28]

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[28] Assuming electric companies have any relevance to the capital structure determination (as opposed to return on equity), they show similar disparities. The 29 electric utilities in the Bauhard and Litzenberger groups have equity ratios ranging from 36.34% to 51.45%. (Ex. 157, Sched. 2, pp. 3-4).

For all these reasons, the MPUC erred in using a hypothetical capital structure in this proceeding. Its OAR should, therefore, be reversed with a mandate to reinstate its original determination utilizing the capital structure of US WEST or to utilize NWB's capital structure.[29]

B. THE MPUC'S DECISION TO IMPUTE HYPOTHETICAL DIRECTORY REVENUES IS CONTRARY TO LAW, UNSUPPORTED BY SUBSTANTIAL EVIDENCE AND ARBITRARY AND CAPRICIOUS.

1. The MPUC's Decision to Impute Revenues Is Barred By This Court's Decision in the Prior Appeal.

Issues related to the directory transfer and the appropriate regulatory response were before this Court in *Application of Northwestern Bell Tel. Co.*, 367 N.W.2d 655 (Minn. App. 1985). This Court was there informed that NWB's financial data had been so presented as to insulate ratepayers from any adverse impact of the directory decision and that, because of deficiencies in the available accounting data, there were differences of opinion regarding the ultimate impact on ratepayers. (*See* A-313-318). In light of this controversy, this Court reversed the MPUC's decision to order NWB to resume publishing directories. In light of the fact that ratepayers had been protected, and the existing controversy about the ultimate effect of the transfer, this Court held:

> "Accordingly, this case is remanded to the Commission to enter findings consistent with this opinion and the

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[29] If the Court agrees that the *Henry* decision established the law of the case on this issue, the MPUC should be directed to use US WEST's capital structure, as it did in the 1984 Rate Order. If, however, the MPUC was free to reconsider this issue in the OAR, it should have used NWB's capital structure, and the Court's mandate should so direct it now. As noted earlier, these structures closely approximate each other.

> Commission is ordered to reinstate the contract between Northwestern and West Direct. The Commission can make a review of the transfer and its future impact on Northwestern's rates *on a more complete record in the next rate case.* If appropriate, an adjustment can be made *at that time.*" (367 N.W.2d at 663, emphasis added).

In a subsequent, related decision, this Court upheld an MPUC order imposing substantial new, detailed accounting requirements on the Company with regard to directory matters so that more reliable and complete information would be available in the next case. (*See Application of Northwestern Bell Telephone,* 371 N.W.2d 563 (Minn. App. 1985)).

The MPUC ignored this Court's direction. It did not enter findings consistent with the Court's opinion. Nor has it abided by the Court's admonition that adjustments, if appropriate, should be made after an evaluation, based on a more complete record, in the next rate proceeding. Instead, based on the same record—with no new evidence—the MPUC made rate adjustments. The law is clear that the MPUC cannot act contrary to the reviewing Court's mandate. In *Holden v. Farwell, Ozmun, Kirk & Co.,* 34 N.W.2d 920 (1948), the Supreme Court held, that on remand, not only the express findings and conclusions in the Supreme Court's decision had to be followed, but also any findings inherent and implicit in that decision. *See, also, In Re Estate of Boysen,* 351 N.W.2d at 398, 400-401 (Minn. App. 1984); *Tankar Gas, Inc. v. Lumbermen's Mut. Casualty Co.,* 9 N.W.2d 754, 758 (1943). Here the MPUC acted flatly contrary to this Court's mandate.

The MPUC's action is also contrary to the law of the case as established by this Court. *See Lange v. Nelson-Ryan Flight Service, Inc., supra*; *see also, Minnesota Power & Light Co. v. Minn. P.U.C.,* 342 N.W.2d 324 (Minn. 1983). It is also barred

by the doctrine of *res judicata*. *Roseberg v. Steen*, 363 N.W.2d 102, 105 (Minn. App. 1985); *Hauser v. Mealey*, 263 N.W.2d 803, 806 (Minn. 1978); *Shimp v. Sederstrom*, 233 N.W.2d 292, 294 (Minn. 1975).

The MPUC could not, consistent with the Court's prior decisions, make major adjustments to NWB's revenue requirements.

2. The MPUC's Decision To Impute Directory Revenues Is Contrary To Other Applicable Principles of Substantive Law.

Under Minnesota law, the MPUC can make affiliated interest adjustments only in limited circumstances. In *Northwestern Bell Telephone Company v. State*, 216 N.W. 841, 854 (Minn. 1974), the Supreme Court held:

> "[I]t seems to us unreasonable to arbitrarily penalize the company for doing business with an affiliate where there is no evidence that subscribers would benefit by the company's securing supplies elsewhere. That is not to say that if prices charged both by the affiliate and by its competitors are exorbitant and improperly reflect leverage obtained by monopolistic practices, the commission would not be warranted in disallowing what is excessive."

As noted by this Court in *Application of Northwestern Bell Tel. Co.*, 367 N.W.2d at 661, the MPUC's authority is limited to "disregard[ing] *unwarranted* payments to affiliates when calculating the 'just and reasonable' rates." 367 N.W.2d at 661, emphasis added.

The MPUC ignored these standards. It did not analyze the directory contracts or find them to be substantively inappropriate in the fashion required by the Supreme Court. It made no meaningful attempt to adjust the Company's rate

case financials to reflect the impact of the contracts. All the MPUC has done is express a vague concern about the relative benefits of the contracts and impose a heavy penalty upon the Company because the MPUC dislikes the transfer.

This is obvious because NWB's rate case financials were presented on a business-as-usual basis—*i.e.*, as though the transfer had never taken place—and the ratepayers were fully insulated from any alleged detrimental financial effects of the transfer. The MPUC's OAR captures *all* of the benefits of the business-as-usual approach and, by imputing additional hypothetical revenues to NWB—"to allow for the impact of the removal of directory operations"—, the MPUC has placed the ratepayers in a better position than they would have been if the transfer had never taken place. Thus, under the OAR, NWB is placed in the anomalous position of suffering a $2.5 million penalty[30]—and the ratepayers get a $2.5 million windfall—merely because NWB made a lawful business decision with which the MPUC disagrees.

3. The MPUC's Decision To Impute Hypothetical Directory Revenues to the Company is Not Supported By Substantial Evidence and is Arbitrary and Capricious.

Major adjustments to NWB's test year financials must be supported by substantial evidence. *See, e.g., Henry v. Minnesota Public Utilities Commission*, 392 N.W.2d 209, 216 (Minn. 1986); *Hibbing Taconite Co. v. Public Service Commission*, 302 N.W.2d 5, 9 (Minn. 1980). The major adjustment to directory revenues adopted by the MPUC is without such support.

As discussed earlier, NWB's business-as-usual approach fully protected ratepayers. Beyond that, however, the adjust-

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[30] The MPUC has no jurisdiction to impose penalties. *See Coastal Oil & Gas Corp. v. FERC*, 782 F.2d 1249 (5th Cir. 1986); *Southern Union Gas Co. v. FERC*, 725 F.2d 99 (10th Cir. 1984).

ment adopted by the MPUC was faulty in several major respects. The adjustment was not sponsored by any witness to the proceeding; it was merely a refinement of a calculation constructed by the DPS for the first time in its Brief to the ALJ.

Moreover, the adjustment completely ignored the fact that —pursuant to FCC and MPUC prescribed accounting systems —many directly related expenses (*i.e.*, expenses associated with pensions, profit sharing, payroll taxes and general overhead) are not separately identifiable and were not taken into account in the adjustment. (*See* Exh. 359). Thus, the expenses considered in constructing the adjustment are hopelessly erroneous.

Similarly, the adjustment is predicated upon continuation of historical growth in directory revenues. The evidence was to the contrary, demonstrating that past revenue growth was attributable almost entirely to price increases, not volume growth. (Tr. Vol. 45, p. 71). At the end of 1983, directory advertising prices in Minnesota were among the highest in the nation and widespread price cutting and increased competition in the industry was anticipated. (Exh. 317, p. 4; Tr. Vol. 45, p. 71, p. 92). In short, there was no basis to assume that growth in directory revenue was sufficiently certain to form the basis for a major adjustment. *See Northwestern Bell Tel. Co. v. State*, 253 N.W.2d 815, 822 (Minn. 1977).

C. THE MPUC'S DECISION TO REQUIRE THE COMPANY TO REDUCE RATES PROSPECTIVELY DUE TO A NON-EXISTENT TAX SURPLUS IS CONTRARY TO LAW, UNSUPPORTED BY SUBSTANTIAL EVIDENCE AND IS ARBITRARY AND CAPRICIOUS.

The OAR requires NWB to reduce rates to reflect a specific deferred tax surplus *that no longer exists.* Pursuant to

prior MPUC's orders, rates have been reduced on a continuous basis since 1982, so that the entire surplus has been extinguished. Yet the OAR and the MPUC's subsequent orders require NWB to reduce rates prospectively, as though ratepayers are entitled to future rate discounts based on the nonexistent surplus.

This MPUC's decision is contrary to law and confiscatory because it results in an arbitrary reduction in NWB's cost of service and the establishment of rates insufficient to earn the MPUC authorized rate of return. This is contrary to Minn. Stat. § 237.075, subdivisions 5 and 6 and NWB's constitutional right to avoid confiscation of its property.

The decision is also contrary to the decision of this Court in *Application of Northwestern Bell Tel. Co.*, 367 N.W.2d 655 (Minn. App. 1985). One of the issues there was whether the MPUC could require NWB to amortize and return to ratepayers unamortized investment tax credits that NWB no longer owned. This Court held the MPUC erred by reducing NWB's cost of service to reflect non-existent credits. (367 N.W.2d at 661-663). The MPUC attempted essentially the same thing here. It wants to give the ratepayers continuing credit—on a prospective basis—for a surplus that no longer exists.

The situation here is analogous to the investment tax credit issue in the Court's prior decision in another respect. There, this Court determined that the MPUC's decision to reflect non-existent tax credits in the Company's cost of service would violate the Internal Revenue Code. Precisely the same situation exists here.

The Internal Revenue Code requires the "normalization method of accounting" be followed in order to qualify for accelerated depreciation for tax purposes. (Section 167(1)

(3)(G)). Corresponding IRS regulations provide that the taxpayer loses its tax deferral if it fails to normalize. (Treasury Regulation 1.167(a)-11(b)6.) In addition, Treasury Regulation § 1.167(1)-1(h)(2) states:

> "The taxpayer must credit the amount of deferred Federal income tax determined under subparagraph (1)(i) of this paragraph for any taxable year to a reserve for deferred taxes, a depreciation reserve, or other reserve account. The taxpayer need not establish a separate reserve account for such amount but the amount of deferred tax determined under subparagraph (1)(i) of this paragraph and must be accounted for in such a manner so as to be readily identifiable. *With respect to any account, the aggregate amount allocable to deferred tax under section 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal incomes taxes are greater by reason of the prior use of different methods of depreciation* under subparagraph (1)(i) of this paragraph. An additional exception is that the aggregate amount allocable to deferred tax under section 167(1) may be properly adjusted to reflect asset retirements or the expiration of the period for depreciation used in determining the allowance for depreciation under section 167(a)." (Emphasis added).

The Code and Treasury Regulations could not be more explicit. The adjustment adopted by the MPUC violates the normalization standards contained in the Code and regulations and the IRS could easily take the position that, because of this adjustment, the availability of significant accelerated depreciation deductions are lost, to the serious detriment of NWB's Minnesota customers. As an independent tax accountant, Mr. Jeter, testified:

"The impact would be to increase the cost of service. The Company and the Minnesota ratepayers would lose an important source of cost-free capital." (Exh. 39, pp. 21-22).

In this case, the MPUC has failed to consider that its decision violates the Internal Revenue Code and regulations and, as a result of the decision, NWB may lose its right to utilize accelerated depreciation for tax purposes and lose an important source of cost free capital. Failure to consider this likely adverse consequence of its decision renders the MPUC's action arbitrary and capricious.

Finally, there simply is no evidence—the MPUC cites none in either of its orders—to justify the MPUC's decision that ratepayers must continue to receive a windfall, in the form of reduced prospective rates, due a surplus already fully returned to them.

D. THE MPUC'S DECISION TO REQUIRE THE COMPANY TO GIVE SERVICES AWAY FREE OF CHARGE IS CONTRARY TO LAW, UNSUPPORTED BY SUBSTANTIAL EVIDENCE AND IS ARBITRARY AND CAPRICIOUS.

The MPUC's orders requiring NWB to give away services and dictating the method of calculating the resulting loss are affected by major errors and must be reversed.

1. The Requirement That the Company's Must Give Away Services Violates Minn. Stat. § 237.21.

Minn. Stat. § 237.21 prohibits the MPUC from approving any rate that tends to destroy competition or to create a monopoly. This statute obviously exists to protect competition and insure its benefits to ratepayers. The MPUC's decision to require NWB to give Touch Tone and Speed Call 8 services free to eligible customers is contrary to this statute. Other

vendors marketing equipment that provide competitive services obviously cannot compete with NWB's "free services." Thus, other vendors are being foreclosed—by virtue of the MPUC's decision—from major segments of the market for their equipment.[31] The destruction of competition in this manner was precisely what Minn. Stat. § 237.21 was intended to prevent.

2. The MPUC's Decision Is Not Supported By Adequate Findings.

The MPUC's decision to require NWB to give away services is not supported by adequate findings. First, the ability to demand free services is not related to an eligible customer's ability to pay for the service. Under the MPUC's decision, a wealthy eligible customer is entitled to free service. Thus, the MPUC's plan is not reasonably related to the objective the MPUC seeks to achieve—or at least the MPUC has not made findings to demonstrate that fact.

Second, this decision is not supported by reasonably detailed findings necessary to demonstrate that the MPUC has engaged in reasoned decision making. *Yellowbird, Inc. v. MSP Express, Inc.*, 377 N.W.2d 490, 494 (Minn. App. 1985). For example, the OAR and the ODR contain no findings at all on a variety of critical matters—including how many customers are eligible, how many currently subscribe to the services; how many will subscribe if the services are free; the financial impact of the decision on NWB; and the impact on its competitors. Absent such findings, this Court cannot conclude the MPUC engaged in reasoned decision making.[32]

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[31] NWB estimated, for example, that 232,889 customers would be eligible for free Touch Tone service and 123,889 customers would be eligible for Speed Call 8 services. (A-281-282).

[32] Of course, the MPUC could not make findings on these critical issues because no one was aware that the MPUC was even contemplating requiring NWB to give away services and *no* evidence was introduced on these issues.

3. The MPUC's Decision Is Not Supported By Any Evidence and Is Arbitrary and Capricious.

NWB is not aware of any evidence, or any proposal made by any party, suggesting NWB should give away Touch Tone or Speed Call 8 services to the class of customers the MPUC has defined. Nor is NWB aware of any evidence supporting the MPUC's method of determining the revenue NWB will lose, or additional costs NWB will incur, as a result of the MPUC's decision.

The MPUC simply decided—as a matter of the exercise of its will, rather than the exercise of reasoned judgment—that NWB could afford to give away services to handicapped customers. When the MPUC made its decision, it had no evidence of the number of customers eligible for free services, or how many of them actually subscribe to these services, or how much revenue NWB would lose, or what additional costs NWB would incur. Simply stated, there was no basis upon which the MPUC could make an informed judgment on these matters.

The MPUC cannot justify its actions on the grounds that it involves rate design. Even there, the MPUC cannot act in an arbitrary fashion and must engage in reasoned decision making. Its action does not meet even these minimal standards and must be reversed. Moreover, the method of computation dictated by the MPUC is not merely a matter of rate design; it directly affects NWB's ability to earn its authorized rate of return. The MPUC is not free to manufacture a revenue calculation out of whole cloth, thereby negating major portions of the approved rate increase and undermining NWB's ability to earn the authorized return. Yet, that is precisely what it did here; it required NWB to assume, without any basis in fact, that it has the same number of eligible customers

today that it had in 1983; it required NWB to assume, without any basis in fact, that only those customers eligible for service in 1983 will subscribe to these services today, when they are free. Of course, both assumptions are nonsense and serve only to confiscate NWB's property.[33]

4. The MPUC's Decision Confiscates the Company's Property.

The MPUC's decision confiscates NWB's property in several respects. It prohibits NWB from charging a reasonable rate for its services in violation of Minn. Stat. § 237.06. It also disables NWB from developing the market for these services at reasonable rates. NWB estimates the size of the market—in terms of annual revenue from eligible customers—being foreclosed to it is more than $9 million. (App-287). Finally, the MPUC has precluded NWB from recovering costs it will undoubtedly incur in providing free services to new, eligible customers that subscribe to these free services.[34] Confiscation of this sort is constitutionally prohibited and must be condemned by this Court.

5. The MPUC Lacks Jurisdiction to Require the Company to Give Away Service.

Pursuant to Minn. Stat. § 237.06, NWB is obligated to charge reasonable rates. Under § 237.075, subds. 5 and 6 and

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[33] The proof of this is obvious. If the MPUC believed that its assumptions were sound, there would have been no reason to require NWB to forego non-recurring charge because under the MPUC's assumptions, no additional customers would subscribe to the services and incur the non-recurring charges.

[34] The MPUC's attempt in its July 21, 1987 Order, to avoid this problem by requiring NWB to report actual results at the end of six months' experience of providing free services, is of no avail. All that Order offers is six months of confiscation with an undefined suggestion that something might be done about the matter at a later date. (A-284).

§ 237.081, the MPUC is obligated to set just and reasonable rates. Nothing in these statutes suggests that "without charge" for a valuable service might constitute a "just and reasonable rate." In fact, Minn. Stat. § 237.21 suggests the contrary, particularly when there are competitors in the market. The MPUC has exceeded its authority and jurisdiction.

The MPUC cannot justify its decision on the ground that it is free to provide subsidies to needy subscribers in order to promote universal services or to "facilitate the use of the telephone system" by handicapped persons. The MPUC's decision is not based upon inability to pay for services. Under the MPUC's orders a wealthy subscriber with a handicapped child is eligible for free services.

Moreover, the legislature recently demonstrated it has retained, and is willing to exercise, authority to determine what subsidies are appropriate for particular classes of customers. During the past session, and only after extensive debate, the legislature adopted a Telephone Assistance Plan for the elderly (Minn. Laws, Chapter 340, §§ 13-17, Minn. Stat. §§ 237.69-237.72 (1987)) and a plan to assist the handicapped to procure equipment to enable them to improve their access to the telephone network. (Minn. Laws, Chapter 308, Minn. Stat. §§ 237.50-237.56 (1987)). Had the legislature believed that further subsidies—in the form of free services—were necessary to "facilitate" the use of the network, the legislature certainly would have adopted such a program. It did not; and the MPUC cannot.

E. THE ORDER AFTER REDELIBERATION AND THE ORDER DENYING RECONSIDERATION ARE AFFECTED BY SUBSTANTIAL LEGAL AND PROCEDURAL ERRORS.

1. Denial of the Company of the Opportunity to Present Oral Argument to a Majority of the Commissioners Who Rendered These Decisions Violates Due Process and the Administrative Procedures Act.

The MPUC issued the OAR in April, 1987, based on the prior record, without affording NWB an opportunity to present oral argument on the merits, even though NWB's Exceptions to the Hearing Examiner's Report requested the opportunity to do so. (A-310). Similarly, the MPUC issued the ODR without allowing NWB to present oral argument. In both instances, the MPUC either overlooked or ignored NWB's specific requests to present argument. (*See* A-312-313).

Because three of the current Commissioners are new since the 1984 Rate Order, NWB has been given no opportunity to argue the merits to a majority of the MPUC that issued the OAR and ODR. NWB has thus been deprived of its constitutional and its statutory rights.

Minn. Stat. § 14.57 requires agencies to decide contested matters in the manner specified in the Administrative Procedures Act. Minn. Stat. § 14.61 requires that decisions in contested cases shall not be made unless each party adversely affected has been afforded an opportunity to "*present argument to a majority of the officials who are to render the decision.*" "Argument" means "oral argument" and a request to present argument *cannot* be overlooked or denied. (*See Matter of Haugen*, 278 N.W.2d 75 (Minn. 1979); *Yellowbird, supra*; *In the Matter of Determining the Natural Ordinary High Water Level of Lake Pulaski*, 384 N.W.2d 510, 515 (Minn. App. 1986)).

Moreover, as pointed out by the Minnesota Supreme Court in *Haugen, supra*, ". . . . even apart from the statute, basic concepts of fair play . . . require" that a party be given a

meaningful opportunity to present argument before the officials who will be deciding the merits of a contested case. If that opportunity is not granted, there is a "lack of basic fairness in the decision making process." *Yellowbird, supra.* Such basic fairness is guaranteed by both the state and federal constitutional.

Here, the right to present oral argument was particularly crucial: the MPUC—with three relatively inexperienced new members who had little personal knowledge of the case—undertook to redecide dozens of complex issues on the basis of the prior record, filings and staff briefings. Even though millions of dollars were at stake,[35] and despite specific requests for the opportunity to do so, NWB was given no opportunity to argue the merits of its position to the new majority of Commissioners. The MPUC's actions violated the literal terms of Minn. Stat. § 14.61 and NWB's fundamental right to basic fairness as part of the decision making process.

2. The MPUC's Failure to Deal With Substantive Issues Raised on Reconsideration is Error.

The MPUC is required to deal fairly and impartially with all material issues raised by the parties (Minn. Stat. § 14.62, subd. 1) and make findings sufficient to allow meaningful appellate review of its action. As the Supreme Court held in

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[35] As previously noted, the MPUC reduced the rate increase from $57.5 to $45.8 million, has ordered NWB to reduce rates prospectively by that amount, has conditioned the stay it issued pending appeal upon a requirement that NWB make refunds retroactive to May 14, 1987, in the event the MPUC's new decisions are affirmed, and has instructed the OAG to sue NWB to recover the difference between the previously authorized rate increase and the newly authorized increase for the period from November, 1983, through May 14, 1987. The OAG recently initiated that litigation, based on the MPUC's OAR, in Hennepin County District Court.

Hibbing Taconite Co. v. Minn. P.S.C., 302 N.W.2d 5, 12 (Minn. 1980):

> "Henceforth, we deem it necessary that the PSC set forth factual support for its conclusion. The PSC must state the facts it relies on with a reasonable degree of specificity to provide an adequate basis for judicial review. We do not require great detail but too little will not suffice."

The failure to do so is not only reversible error as to specific matters or issues, but also indicates the MPUC has not engaged in reasoned decision making, but has exercised its will rather than its judgment. *Yellowbird, supra.*

In this case, the MPUC has failed to fulfill its responsibilities. It made no findings on the substantive issues raised by NWB in its Petition for Reconsideration. The ODR belies any suggestion that NWB's Petition was given meaningful consideration by the MPUC. For example, NWB's Petition specifically raised the following new matters for the first time:

—the Supreme Court's decision in 1986 in the *Henry* case foreclosed action taken by the MPUC in the OAR—both as a general matter and with regard to the use of a hypothetical capital structure.

—the MPUC's *Central* decision (cited and relied heavily upon by the MPUC in the OAR (*See* A-227-228, 230)) had been *reversed* by this Court in *Central, supra,* 356 N.W.2d 696 (Minn. App. 1984).

—this Court's capital structure determination in *NSP, supra,* 402 N.W.2d 135 (Minn. App. 1987), was contrary to the OAR.

—the imputation of directory revenues was contrary to Minnesota Supreme Court decisions and the prior directory decision of this Court.

—the entire surplus associated with the 48%/46% tax rate change had already been returned to ratepayers and that any continuation of the flow through, as required by the OAR was contrary to law, was not supported by the record and subjected NWB to serious tax risks.

—the MPUC's new decision to require NWB to give services away was unlawful and could cost NWB millions of dollars on an annual basis.

Remarkably, in the ODR the MPUC claimed that nothing new had been raised that had not been already thoroughly considered—even though these matters had not been considered at all.[36] In addition to ignoring these serious matters in the ODR, the MPUC undertook—without any legal or factual basis—to expand dramatically the burdens imposed on NWB by increasing the level of services it must give away.

The MPUC has failed to deal fairly with the issues, has failed to make findings to support its actions and has failed to engage in reasoned decision making:

> "[W]here there is a combination of danger signals which suggest the agency has not taken a 'hard look' at the salient problems and 'has not genuinely engaged in reasoned decisionmaking' it is the duty of the court to intervene." (*Yellowbird, supra,* 377 N.W.2d at 493; *Reserve Mining Co. v. Herbst,* 256 N.W.2d 808, 824-25 Minn. 1977)).

Here, the MPUC took no look—let alone a "hard-look"—at salient issues raised by NWB.

3. The MPUC Erred In Attempting to Set Prospective Rates Based on Out-of-Date Financial Data.

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[36] Indeed, the Court will search in vain for any mention of these matters in the OAR *or* the ODR.

Here the MPUC has attempted to use a 1983 test year, adjusted for divestiture, to set prospective rates. Yet, the MPUC made no findings to support the use of the 1983 test year for that purpose. In *Northwestern Bell Telephone Co. v. State*, 253 N.W.2d 815, 822 (Minn. 1977), the Court defined the appropriate use of a test year concept in rate-making proceedings as follows:

> "[T]he test-year concept is designed to produce a measure of a regulated utility's earnings for a known period of time, to enable the regulatory body to make an accurate prediction of revenues and expenses in the reasonably near future. Based upon the evidence presented, the regulatory body undertakes a reasoned exercise of its discretion in altering test-year data to reflect changes of known magnitude occurring subsequent to the test year." (Citations omitted).

Test year 1983 is not reasonably representative of current conditions. There was no rational basis for the MPUC's use of the 1983 data to set 1987 rates and the MPUC has acted in an arbitrary and capricious fashion. Indeed, the MPUC has acknowledged in Docket 354 that more current information is necessary: in its order dated October 24, 1986, the MPUC expressly recognized that not even 1985 data could be used to set prospective rates[37] and that fair and reasonable rates could be set only after a careful examination of complete 1986 financial data, and the resolution of a variety of other substantial matters that would significantly affect NWB's post

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[37] The MPUC and DPS Joint Staff Report showed that, based on 1985 data, NWB's required rate of return was substantially higher than authorized in the 1984 Rate Order and that in 1985 NWB did not even earn the lower authorized return. (A-292). Of course, this is directly contrary to the suggestion in the OAR that rates during this period were excessive. (A-266).

1986 earnings. (A-284). Yet, five months after making these determinations, and without giving any consideration to current conditions, the MPUC issued the OAR slashing current rates by more than $12 million annually. Its action was obviously contrary to law, unsupported by substantial evidence and arbitrary and capricious.

V. CONCLUSION

For the reasons set forth above, NWB respectfully requests this Court to reverse and vacate the MPUC's OAR and ODR in this matter and to remand this matter to the MPUC with instructions to reinstate the 1984 Rate Order in all respects.

APPENDIX 3

C7-87-1296
C9-87-1297

STATE OF MINNESOTA
IN SUPREME COURT

NORTHWESTERN BELL TELEPHONE COMPANY,
Petitioner,

v.

MINNESOTA PUBLIC UTILITIES COMMISSION,
Respondent.

PETITION FOR SUPREME COURT REVIEW

Northwestern Bell Telephone Company ("NWB") seeks review of the Court of Appeals' decision of December 28, 1987, which affirmed two Minnesota Public Utilities Commission ("MPUC") orders. These orders re-opened a three-year-old

final telephone rate case order and prospectively lowered NWB's annual revenue by twelve million dollars. In addition, the Minnesota Attorney General has sued NWB for a three-year refund of revenue already collected under the 1984 final Order. Therefore, the decision of the Court of Appeals jeopardizes approximately sixty million dollars of NWB's shareholders' property.

Supreme Court review is necessary because:

1. In violation of statute and of principles articulated by the Supreme Court, the Court of Appeals has taken the unprecedented step of endowing the Commission with unlimited "inherent" authority to re-open and re-decide a prior contested rate proceeding, previously affirmed on appeal to the Supreme Court, without requiring the MPUC to follow any of the statutorily required procedures in contested rate cases.

2. The Commission deprived NWB of its right to be heard in the reconsideration of the rate case, in violation of this Court's October 1987 opinion in *In re the Petition of Northern States Power Company*, 414 N.W.2d 383, 388 (Minn. 1987) ("NSP").

3. Even though the Commission stated it was unable to determine that the 1984 rate decision was specifically affected by NWB's challenged contacts with the Commission, which were not proscribed by statute or rule, it removed millions of dollars of previously approved rate relief necessary for a fair return on NWB's shareholders' investment as an extreme and unauthorized penalty. Additionally, rate reductions for NWB necessarily affect the compensation NWB pays to over 90 independent telephone companies.

4. The Court of Appeals and the Commission have ignored statutory limitations on the Commission's authority in a novel but misguided effort to protect public confidence in the rate

making process. The Supreme Court's intervention is required to harmonize the cases and the statutory limitations on the Commission's authority.

5. The hypothetical capital structure imposed by the Commission is unsupported by substantial evidence, is drastically different from that unanimously approved in 1984, and constitutes an improper penalty.

STATEMENT OF THE CASE

NWB's 1983 petition to the MPUC (the "Docket 600" petition) sought approval of a $109 million annual rate increase. After nine months of contested proceedings, the MPUC in 1984 granted NWB approximately $57 million in rate relief. In doing so, the MPUC voted 5-0 to impose the capital structure sought by the Attorney General and used by NWB's parent U.S. West, which was based on a ratio of 56.4 percent equity. On appeal, the Supreme Court, after a "careful review" of the evidence and the Commission's 100-page order, held that NWB had met its statutory burden of proof. *Henry v. Minnesota Public Utils. Comm'n,* 392 N.W.2d 209, 216 (Minn. 1986).

In April 1986, while Henry was on appeal, the Minnesota Department of Public Service (the "DPS") began an independent investigation of contacts between utilities and certain former Commissioners. After the submission of the DPS report to the MPUC on July 8, 1986, which criticized certain contacts between NWB and Commissioners Adams and Hanson, several parties moved to re-open the Docket 600 rate case. On April 2, 1987, the MPUC concluded that it was unable to determine that any of the rate decisions were specifically affected by these contacts. It nevertheless granted the motions to reconsider. On April 3, the Commission reduced NWB's 1984 rate increase from $57,511,000 annually to $45,603,000.

By a 5-0 vote, the MPUC imputed to NWB a hypothetical capital structure that included an equity ratio of 50.1 percent. The drastic change of this one issue, which was not found to be tainted by the contacts, reduced NWB's revenue by over ten million dollars annually.

NWB unsuccessfully moved for reconsideration and appealed. The Court of Appeals affirmed, holding that the Commission has "inherent authority," analogous to the district court's power granted by Rule 60 of the Minnesota Rules of Civil Procedure, to re-open and re-decide rate case orders regardless of how long they have been final.

LEGAL ISSUES

1. Does the MPUC have "inherent" authority to re-open a three-year-old final order, previously affirmed by the Supreme Court, in a contested telephone rate proceeding?

2. If the MPUC has such authority, was it properly exercised by a reversal of decisions unaffected by the challenged actions and the imposition of a penalty of millions of dollars?

The Court of Appeals answered both questions in the affirmative.

ARGUMENT

The re-opening and redeliberation of the 1984 rate case exceeded the Commission's statutory authority, deprived NWB of its procedural rights and denies its shareholders the opportunity to earn a reasonable return on their investment.

The telephone rate-making statute, Minnesota Statutes Section 237.075, carefully delineates the MPUC's authority and jurisdiction in rate cases. It does not give the MPUC any authority to re-open a rate case. The powers of the MPUC, a creation of the Legislature, are limited to those granted by, or logically necessary to the exercise of those granted by, the legislature. *Peoples Natural Gas Co. v. Minnesota Public*

Utilities Comm'n, N.W.2d 530, 534 (Minn. 1985); NSP, supra at 387-388. Jurisdiction lies more properly in the district court, a court of general jurisdiction statutorily authorized by the Administrative Procedure Act to hear and decide issues of procedural irregularities outside the record that arise during an appeal. See, e.g., *Minn. Stat.* § 14.68. In permitting the Commission to exercise an unlimited, undefined and unprecedented "inherent authority," the Court of Appeals has totally disregarded the limits on authority granted by the Legislature and has permitted the Commission unfettered discretion to suspend the statutes and rules. This Court must not likewise suspend its authority to supervise the compliance of a governmental agency with its statutory directives.

It is important to recognize that the contacts challenged here are different in kind and degree from those in *NSP*, supra. NWB's contacts consisted of conversations over meals paid for by NWB, on matters other than the rate case, and did not involve any employment negotiations. In *NSP*, on the other hand, the MPUC investigated an offer of employment, later accepted, by NSP to a sitting Commissioner during a contested rate case. Furthermore, unlike the telephone rate statute, the electric and gas statute explicitly authorized the reopening of rate cases, and NSP timely requested reconsideration of that case. *NSP, supra*, at 387.

By contrast, the MPUC's action toward NWB:

1. Occurred many years after the rate case was decided and affirmed on appeal by the Supreme Court.

2. Lacked any statutory authority.

3. Was based on conduct not prohibited by a then existing statute or rule.

4. Was not limited to reconsideration of issues affected by the contacts.

5. Was not invited by NWB.

The Commission's unanimous reversal of its 1984 vote on capital structure, and its imposition of a hypothetical structure in the face of overwhelming evidence to the contrary can only be explained as punitive. In effect, the MPUC imposed sanctions of twelve million dollars annually without authority and without a hearing.

For the foregoing reasons, NWB requests Supreme Court review of the unprecedented decisions of the Court of Appeals and the MPUC.